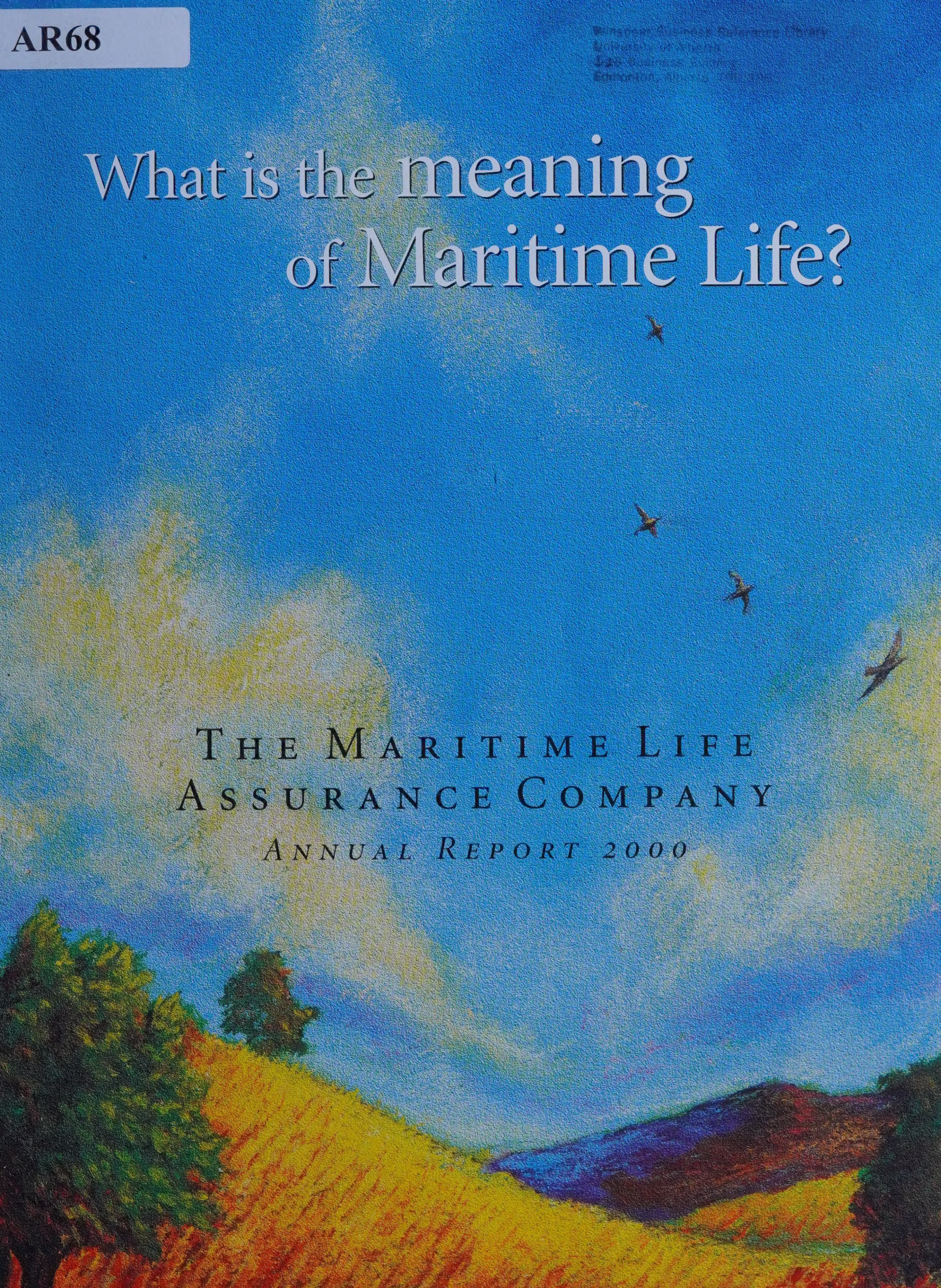


# What is the meaning of Maritime Life?

THE MARITIME LIFE ASSURANCE COMPANY

*ANNUAL REPORT 2000*

# Table of Contents



# Financial Highlights

| *(in millions of dollars)* | 1996 | 1997 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Assets Under Administration | $ 7,034 | $ 8,078 | $ 9,097 | $ 10,586 | $ 11,509 |
| Capital and Surplus | 484 | 556 | 618 | 889 | 970 |
| Total Revenue (General Fund only) | 1,599 | 1,468 | 1,610 | 1,829 | 1,795 |
| Net Income to Shareholders (after tax) | 32 | 37 | 33 | 36 | 86 |
| Inforce Individual Insurance Premiums | 305 | 342 | 489 | 519 | 542 |
| Inforce Living Benefits Premiums | 51 | 55 | 60 | 67 | 72 |
| Inforce Group Insurance Premiums and Premium Equivalents | 905 | 999 | 1,109 | 1,330 | 1,445 |
| Investment Product Assets Under Administration | 3,973 | 4,529 | 4,852 | 5,692 | 6,136 |

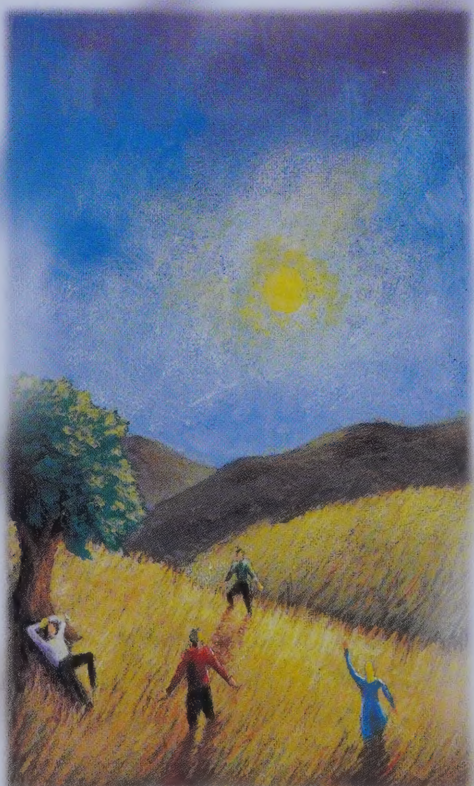
# Who do we think we are?

Maritime Life has been helping Canadians achieve financial security since 1922, and is a leading supplier of individual life insurance, living benefits, investment products, pensions, and group life and health products and services. From our offices in Halifax, Montreal, Toronto, Kitchener, Calgary and Vancouver, approximately 1,900 employees use their knowledge, professional judgement and skills to meet and exceed customer expectations.

Naturally, many of the ways we operate have changed over the years, but the fundamental philosophies that have always guided our company endure. We believe that independent financial advisors are in the best position to help Canadians make informed decisions. Today, the Equinox Financial Group complements Maritime Life's advice-based distribution strategy and strengthens the company's position as the largest life insurer to rely exclusively on a national network of independent financial advisors.

Our group benefit plans are designed to foster the health, well-being and peace of mind of plan members. We collaborate closely with plan sponsors and their benefit consultants, brokers or advisors to structure and administer benefit plans that deliver this level of security.

But a philosophy is valuable only if it works in the real world. In this report, we've asked a few people who know us well to explore the meaning of Maritime Life through their own experiences.



# The John Hancock Connection

*Founded more than 135 years ago, John Hancock has long been known for financial strength and stability. They stand by their customers, offering individuals and institutions some of the best products such as annuities, mutual funds, life insurance and long-term care insurance. Today, John Hancock is among the highest-rated insurance companies as judged by the major rating agencies. Along with their subsidiaries, John Hancock has more than $127 billion (US) in assets under management as of September 30, 2000. Success is based on the depth of products and outstanding service. Their vision for the future is one of innovation and a continued focus on customer needs.*

*Tom Moloney*

## TOM MOLONEY

*CHIEF FINANCIAL OFFICER*

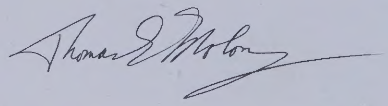
*JOHN HANCOCK FINANCIAL SERVICES, INC.*

With more than three decades of partnership, Maritime Life and John Hancock Financial Services have discovered many ways to benefit from each other's operations.

One of the greatest assets I see these days is a highly effective two-way transfer of knowledge and ideas. We often use the specialized expertise of one company to help launch an initiative for the other. For example, a couple of years ago, when the Hancock organization wanted to develop a new broker/dealer distribution channel, Maritime Life's President and CEO, Bill Black, worked with us in Boston for several months and played an invaluable role in getting us started. John Hancock is currently sharing its particular strengths and a variety of ideas with Maritime Life in the area of e-business and a new product design that will use the strengths of both organizations.

As a holding company, we have established two key priorities for all our business units: customer service and shareholder value. From my perspective, Maritime Life's strong and focused management team has done a particularly good job on both of these fronts.

As we look into the future, I believe we're going to find a lot more synergies developing. In particular, I see the brands of Maritime Life and John Hancock emerging as a key strength for 2001 and beyond.



# President's Message

**BILL BLACK**
*PRESIDENT AND CEO*

In 2000, we began the process of bringing together two great companies—Maritime Life and Aetna Canada. Our objective is to make Maritime Life financially stronger, improve our service and value to customers, and to earn a better return for our shareholder. After only one year we made great progress thanks to the efforts of our employees, but we have only begun to see the tremendous potential our acquisition of Aetna Canada can bring to our customers, our employees and our shareholder.

While the integration meant a lot of change for our employees, we have stayed true to our Vision and Values. We are here to serve our customers, and will treat each customer the way we want to be treated—with respect and honesty. In this report you can read about how customers and employees see our Values in action at Maritime Life.

All of the reasons that we were delighted to acquire Aetna Canada are, if anything, more valid today than a year ago. The benefits of greater size will improve both our return to our shareholder and our ability to invest in service improvements to customers. Our greater presence in the marketplace improves our growth prospects and facilitates our unique commitment to regional service delivery.

The year 2000 saw a dramatic improvement in net income to common shareholders from $36 million to $86 million. In part, this was because 1999's results had included significant transaction costs related to the acquisition of Aetna Canada. Of much greater impact was the significant benefit we are beginning to realize from the combination of the two companies. While these synergies will be spread over many years, the policy liabilities determined at December 31, 2000 are reduced by the benefit of those synergies that will be manifested over the future life of the inforce policies.

*We are here to serve our customers, and will treat each customer the way we want to be treated—with respect and honesty. In this report you can read about how customers and employees see our Values in action at Maritime Life.*

Our goal in 2000 was to make significant progress in the integration of the people, policies, systems, procedures, and physical facilities in our various offices across the country as a result of our acquisition of Aetna Canada. At the same time we wanted to maintain strong relationships with all our customers. While some of our measures of customer satisfaction dropped, few customers experienced disruption to service as a result of the merger.

One of the most important steps is bringing employees in each city together under one roof. This has been accomplished with excellent new facilities in Vancouver and expanded offices in Montreal. In Calgary and Toronto, we have made the best possible use of our existing lease structures. We were delighted to join with O&Y Properties in announcing development of the Maritime Life Tower. This will be the first major office building in downtown Toronto in over ten years, and we will be the anchor tenant starting early in 2003.

We have always believed that satisfied employees lead to satisfied customers and so we were delighted to hear early in 2001 that the Globe & Mail Report on Business has again selected us, in an increasingly competitive field, as ninth overall among Canada's *35 Best Companies to Work For.* Notwithstanding this, we know there are a number of issues of concern to our employees, including the stresses associated with change and frequently excessive workloads.

During the year we involved hundreds of employees in developing the policies and programs that define the employment relationship at Maritime Life. The resulting package was the product of excellent work. It also represented a lot of change for employees to absorb. This—combined with the inevitable heavy integration workload—resulted in a reduction in employee satisfaction from 89 per cent to 81 per cent in our annual survey. A mini-survey late in the year confirmed that these issues were still having an impact.

Satisfaction among our Retail distributors was 90 per cent in 2000, an excellent result for a year of integration activity. In Group Insurance, the result was 87 per cent—lower than our usual 90+ per cent result, but still a very positive outcome. We have experienced excellent retention of group customers in spite of the need to ask for significant rate increases on some cases in order to make them profitable. And we are very excited about the major new systems that will be deployed in 2001 to substantially improve the quality and efficiencies of our service.

Retention of our Retail customers has continued to be excellent, although Retail customer satisfaction was lower in 2000. For many former Aetna Canada customers, exposure to Maritime Life is fairly limited thus far. As they get to know their new company they will realize that, much like Aetna Canada, we have a strong commitment to customers and we expect customer satisfaction to increase. With many of the demands of integration behind us, we can now focus upon the improvement initiatives desired by customers.

Financial markets were particularly turbulent in 2000, resulting in roller coaster returns for many investors. The impact of this was mitigated for most of our segregated fund customers by the prudent diversification of their portfolios and the superior returns of our funds:

**Equity Fund Returns vs Benchmark Returns**

*(for one year ended December 31, 2000)*

| | |
|---|---|
| Canadian Equity Fund | 24.78 % |
| Diversified Equity Fund | 6.01 % |
| Dividend Income Fund | 12.42 % |
| Growth Fund | 7.15 % |
| American Growth & Income Fund | 10.23 % |
| TSE 300 Index | 7.41 % |
| S&P 500 Index (C$) | −5.52 % |

As well, most of our Investment Products customers benefit from a superior guarantee on their death benefits and maturity values.

In contrast with equity markets, our general fund bond and mortgage portfolios were remarkably stable during 2000 with credit experience continuing the very favourable trend of 1999. Over $450 million of assets acquired through the Aetna Canada acquisition have been repositioned to maximize profits, a process that will continue throughout 2001.

In 2000, the primary focus for our Group Insurance division was on existing customers, and accordingly we anticipated a reduction in sales. Nevertheless, we had $166 million of sales. Together with excellent customer retention and growth, this meant that our inforce premium and equivalents increased from $1.3 billion to $1.4 billion.

Sales of investment products increased 21 per cent to $1,157 million, while sales of life-insurance were flat at $65 million of new annualized premium. Sales of living benefits products fell during the early part of the year but rebounded in the fourth quarter to end at $7.6 million, 90 per cent of the previous year.

The first year of a major integration process is now behind us.

We are pleased that as the new year begins, more and more of our efforts and attention are refocusing on customer issues. The essays that follow in this report seek to capture the distinctive flavour that permeates our way of doing business. We are confident that the end result of our efforts will be an even better Maritime Life.

W.A. Black.

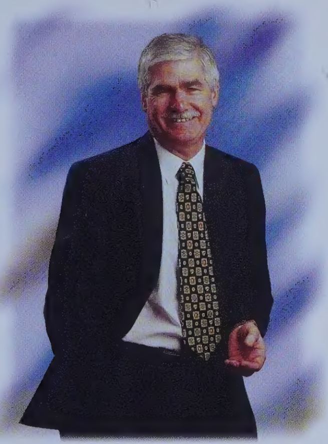
William A. Black
President and CEO

*We were delighted to join with O&Y Properties in announcing development of the Maritime Life Tower. This will be the first major office building in downtown Toronto in over ten years, and we will be the anchor tenant starting early in 2003.*

# How did we get here?

Phil Pothier

PHIL POTHIER
*SENIOR VICE PRESIDENT*
*AND CHIEF FINANCIAL OFFICER, MARITIME LIFE*



# *Twenty-five years ago, Maritime Life was a young company whose unconventional ideas sometimes upset a traditional industry.*

In those days we had little to lose and a lot to gain by choosing a radically different course. Not every venture succeeded, of course. But many of the changes we pioneered, such as selling through independent financial distributors rather than career agents, and introducing the first adjustable products (the forerunner of today's universal life product), have since been widely adopted.

In today's global environment, the life insurance industry faces new challenges. The trend to ever-larger institutions is blurring the lines between financial service suppliers and introducing a different type of competition—one where sheer size may become significant. And e-commerce is certainly changing the way most industries interact with their customers. Maritime Life's future success will depend on how creatively we respond to factors such as these.

We firmly believe that there is both room and an important role for the life insurance company we have grown to become. If today's strategies tend to be evolutionary rather than revolutionary, the trademark innovative thinking that caused waves during Maritime Life's early days still permeate every part of our corporate life. Flexibility is a powerful asset in a continuously changing marketplace.

We built our reputation with superior customer service and well-designed products that represent good value. These remain our highest priorities. But we will never be content to be followers. This means continually looking for better ways to anticipate and respond to our customers' and distributors' changing needs. Some customers will always want traditional in-person service. Others expect full access to information so they can make their own decisions. Most sit somewhere between. We continue to monitor e-commerce developments to determine how we can best harness new technologies to serve and communicate with our customers and agents—however they prefer.

Above all, we believe that Maritime Life's real difference has always been our people. Whether dealing through the e-world or the more traditional methods of interaction with distributors and customers, service and creativity remain the key to our success. The company that chooses and keeps the best people will always have the edge. We are determined that Maritime Life will continue to be that company.

# What do you want from us?

## Stephen Liptrap

*Vice-President Human Resources for Canada, the Caribbean and Latin America, NCR, Toronto*

*I can't imagine anyone better to work with than our Maritime Life account rep. She listens to what we need and pulls all the pieces together from the different departments within Maritime Life.*

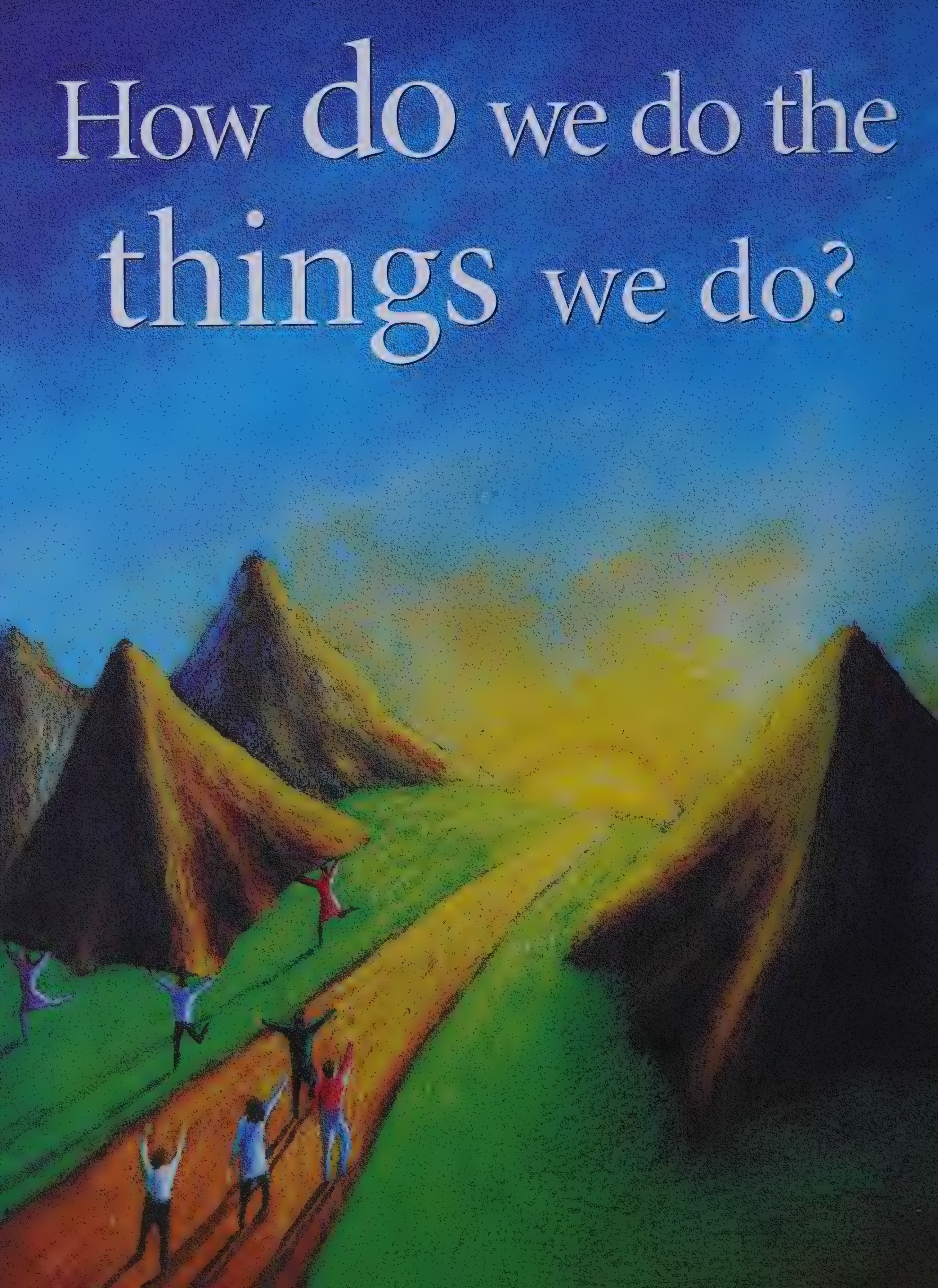
This is great for us because it always feels as though we're dealing with just one person rather than a large company.

What I find really different about Maritime Life is their willingness to be creative. Our company's needs are complex. We're continually looking for ways to manage our business better. Maritime Life helps us fine-tune our benefit systems to work more effectively. They are always willing to take any question or challenge we put to them and explore the options. They'll often come back to us with solutions and different ways of looking at the particular issue.

I believe the strength of our relationship comes from the fact that Maritime Life really understands our business and where we're coming from as a client. It's more than being responsive to our needs. Maritime Life plays a key role in our planning activities. Our benefit consultant relies on them for statistical analyses of current programs and for information about emerging industry trends.

Many of the major human resource changes NCR has made in recent years have been developed in partnership with Maritime Life. For example, our company has worked hard to find ways for our human resource managers and consultants to devote more of their time to value-added business activities. To do this, we had to free them from many routine tasks. Maritime Life helped us find the best way to outsource the administration of our short-term disability program and later our flexible benefits program.

The process involved in successfully making major changes like these is fascinating. It takes real dedication and a lot of learning on both sides. That's another part of this relationship. It's great fun to be on the leading edge and working with a great partner—both trying to outrun the competition.


How do we do the things we do?

## Susan Mellors

*Team Leader, Disability and Life Claims*

*Maritime Life*

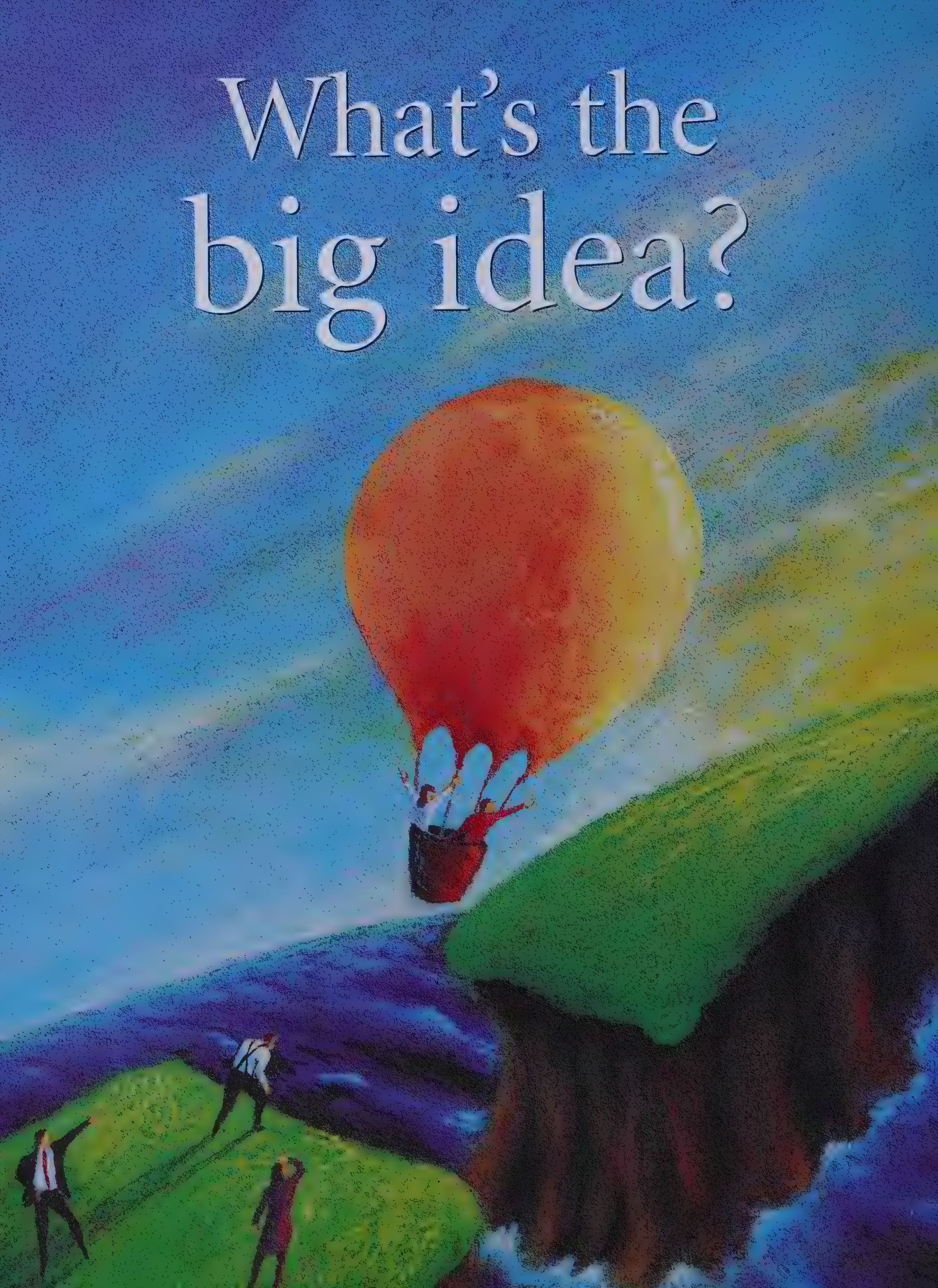
*Maritime Life has a saying: 'If it is good for your customer and you know it makes sense, then do it.' It's not just a slogan, it's the way we work in our department.*

I like being able to make my own decisions. I value the responsibility. Maritime Life encourages us to develop our judgment, then trusts us to use it. If you take a risk because you believe something will work for a customer and it doesn't, you'll never be reprimanded for your action—and the experience you've gained helps you grow. Your new knowledge also becomes a resource.

In our department, the disability management consultant, the case manager and the team leader all have responsibilities for specific aspects of a claim—such as deciding how much money we will spend on retraining or how to communicate a decision—but we manage each file collaboratively. This approach works because even though as individuals we may be very diverse, everyone on the team has the same goal. We want to be profitable, fair, fast—and we want to do it right the first time.

The team's strength lies in our different experiences and skills. With these collective resources at our disposal we can be very creative in finding ways to reach the best resolution for each case. Part of my job is to identify all our individual strengths and make the best use of them. One of the most satisfying aspects for me is watching people's talents emerge as they work together and learn from each other.

Claim management is about people. It can be difficult and sometimes stressful but it's very satisfying work. If we do our job well, we can make a real difference. We can't make everybody happy, of course, but we can always help them to understand if a decision is not the one they wanted. At the end of the day, being able to help someone is important. I am privileged to work with doctors and nurses, and when we are able to help someone—perhaps a whole family—that makes me feel good.


What's the
big idea?

## Erin McDonah

*Manager, Retail Marketing*

*Maritime Life*

*Maritime Life has a reputation within the industry for being receptive to new ideas. That the company encourages original thinking probably has a lot to do with this image.*

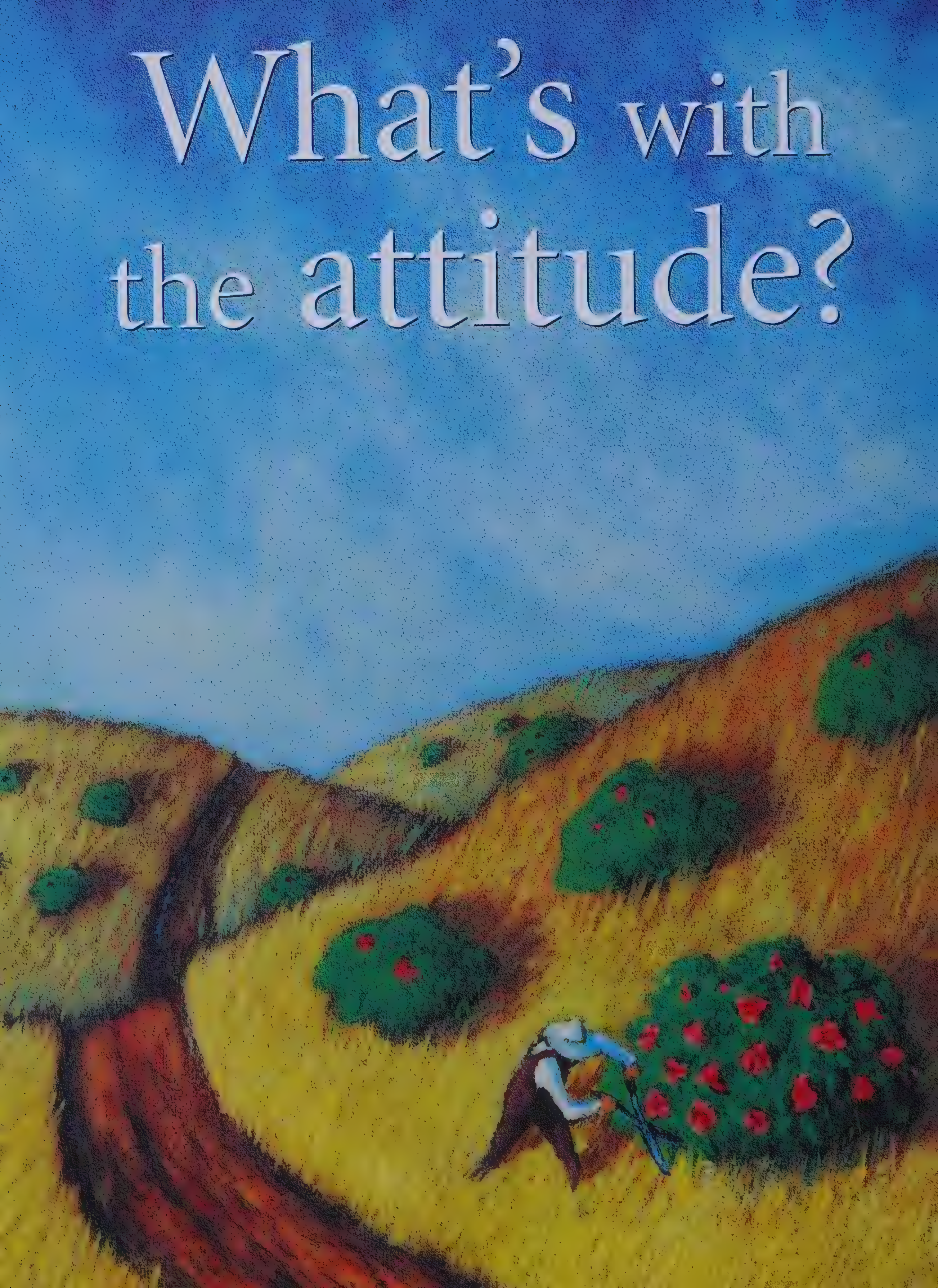
We strive to develop products that respond to customer needs and set us apart from the marketplace, often seeing potential where perhaps our competitors don't. For example, with our segregated funds, Maritime Life is the only company that offers an automatic daily reset allowing customers to select a maturity date that coincides with their personal financial horizons. While other companies were competing at one end of the market, Maritime Life chose a different direction—one that we think provides investors the best long-term value.

Because original thinking is a fundamental part of our corporate culture, no one feels that creativity is the exclusive responsibility of a specific work group. Despite rapid growth over the last two years, Maritime Life has managed to retain a personal feel so we are comfortable about putting ideas forward.

This type of creative openness is very important to our marketing team. We put together materials and programs to market Maritime Life's personal financial planning products. The independent financial advisors who sell our products have a wide range of options and many suppliers from which to choose. For Maritime Life to thrive we must be responsive to the marketplace with offerings that set us apart from the competition.

Not every idea is original; sometimes the creativity comes in seeing something familiar through fresh eyes. There are so many ways creativity can express itself. When you keep an open mind, you never know where an idea might take you. I believe that for Maritime Life, original thinking is more than a means to a competitive edge, it's part of our personality.

# What's with the attitude?



## Claude de Gagné

*President, de Gagné Clément Barkovich, Montreal*

*When our company looks for a solution for a client, we want absolutely the best product for that specific need.*

I believe it is vital for a general agent to remain independent and to be able to choose freely among suppliers. But I am also delighted that we have been associated with Maritime Life since 1971.

Our individual and corporate clients typically have very complex requirements. We demand top quality in every insurance product—that goes without saying—but it is the professional support we receive from Maritime Life that makes the real difference. To service our clients effectively, we need fast, complete access to information after the sale. Maritime Life has always been the leader in this area. It's why we look to them first.

I also appreciate their eagerness to understand changing markets. We use a lot of customized products. They really listen to our clients' needs and are very willing to adapt a product to fit—even if it's only for a single sale. I've noticed that if they find they don't have a specific mass-market product, they make it a priority to develop one. They also take the time to ask our opinions about possible new developments.

But this professional relationship has another side that I believe is unique in the industry. I know this is not just our company's experience because many general agents from across the country have told me the same thing. Maritime Life is accessible. I can pick up the phone and the president will take my call—not because we are an important customer, but because this is the way they do business with everyone. We have this type of access to everyone in the company. In fact, so much of the way they do business gives me the feeling that people are as important as numbers and money to Maritime Life. The company has grown considerably, but this attitude hasn't changed.

For us it's an excellent professional working relationship but it's also a partnership—and often a friendship too. I'm sure we'll be working together for at least another 30 years.

# Senior Management Team

**Maritime Life's Senior Management Team** *(left to right)*

*(back row)*

| | |
|---|---|
| Patricia A. Smith | *Senior Vice President, Corporate Resources* |
| Norm Ayoub | *Senior Vice President, Retail Marketing* |
| Bob Nicholas | *Senior Vice President, Group Insurance* |
| Peter Stuart | *Senior Vice President and Chief Investment Officer* |
| Al Hillier | *Senior Vice President and Chief Technology Officer* |

*(front row)*

| | |
|---|---|
| Kirk McIntyre | *Senior Vice President, Retail Services* |
| Bill Black | *President and CEO* |
| Phil Pothier | *Senior Vice President and Chief Financial Officer* |

# Executive Management

William A. Black, FCIA, FSA
*President and Chief Executive Officer*

Al Hillier, FLMI, CDP
*Senior Vice President and Chief Technology Officer*

Norm Ayoub, CLU
*Senior Vice President, Retail Marketing*

Kirk McIntyre, FCIA, FSA
*Senior Vice President, Retail Services*

Robert M. Nicholas
*Senior Vice-President, Group Operations*

Philip J. Pothier, FCIA, FSA
*Senior Vice President and Chief Financial Officer*

Patricia A. Smith
*Senior Vice President, Corporate Resources*

Peter A. Stuart, CFA
*Senior Vice President and Chief Investment Officer*

Bette Andrews
*Vice President, Group Operations, Ontario Region*

Mel Bartlett, FCIA, FSA
*Vice President, Retail Financial Management*

Cyril Bendahan
*Vice President, Group Insurance, Quebec Region*

Lori Boyce, RHU
*Vice President, Living Benefits Services*

Madeleine N. Clare, FLMI, ISP
*Vice President, Enterprise Technology Services*

Norm Collins, FCIA, FSA, FLMI
*Vice President, Corporate Finance*

Byron Corner, FCIA, FSA
*Vice President and Chief Actuary*

Daniel Dessureault, ASA
*Vice President, National Sales & Distribution*

Erin Flannery, FLMI, ACS, CLU
*Vice President, Corporate Communications and Research*

Derek Frail, FCIA, FSA
*Vice President, Retail Product Development*

Annette Gibbs
*Vice President, Disability Claims*

Heather M. Hannon, LL.B.
*Vice President, General Counsel & Corporate Secretary*

Laurie Harding, CMA
*Vice President, Private Placements*

Robert Hiscock
*Vice President, Group Marketing*

Jan Imeson, CA
*Vice President and Controller*

Joanne Keigan, FCIA, FSA
*Vice President, Group Finance and Actuarial*

Ann M. Kyle
*Vice President, Group Administration Services*

Mary Linton, CFA
*Vice President, Public Securities*

J. Paul Lynch
*Vice President, Retail Customer Services*

Alana MacNeill
*Vice President, Taxation*

Joseph J. Malek
*Vice President, Retail Systems*

Gary E. Martin, FLMI, CFA
*Vice President, Property Investments*

Steve Moffatt
*Vice President, Sponsored Markets*

Ted M. Moffatt, ASA, FLMI (M)
*Vice President, Retail Administrative Services*

Terry Morrison
*Vice President, Atlantic & Trustee, Group Operations*

Shirley L. Mosher, FLMI
*Vice President, New Business & Agency Services*

Catharine Penney, CA
*Vice President, Internal Audit*

Harrison Robbins, FCA
*Vice President, Pensions*

Kirk L.R. Sievert, CMA
*Vice President, Retail Marketing and Strategy*

Robert Sloane
*Vice President, Group Insurance, Western Region*

Cecil Smith
*Vice President, Group Systems*

David M. Star
*Vice President, Investment Products Business Development*

Stephen Townsend
*Vice President, Corporate Business Services*

Kevin Wark, LL.B, CFP
*President and CEO, Equinox Financial*

Catherine J. Woodman
*Vice President, Human Resources*

# Dividend Scale

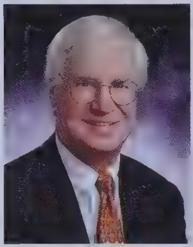
Dividend scales for participating insurance policies are declared on an annual basis and distributed according to the contract. The amount of surplus available for distribution is influenced by trends in earnings and experience, by dividend guarantees and by the need to maintain the long-term vitality of the participating fund. Maritime Life uses the contribution principle to allocate divisible surplus to individual policies in proportion to their contribution to earnings. The allocation process strives to ensure reasonable equity among different classes and generations of participating policies as well as equity among individual policies within each class. The determination of dividends complies with regulatory and professional standards.

# Board of Directors

**William A. Black** (12/12)
Halifax, Nova Scotia 1,4,5
*President and Chief Executive Officer*
The Maritime Life Assurance Company

**Ronald B. Coleman** (17/17)
Calgary, Alberta 2,3,5
*President*
R.B. Coleman Consulting Co. Ltd.

**J. Dickson Crawford** (17/17)
Mahone Bay, Nova Scotia 1,3,4,6
*Chairman of the Board*
The Maritime Life Assurance Company

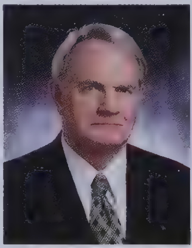


**Kevin Crowley** (6/9)
Boston, Massachusetts 4
*Senior Vice President,*
*General Agency Department*
John Hancock Financial Services, Inc.

**Mark W. (Sam) Davis** (4/4)
Boston, Massachusetts 5
*Second Vice President*
Real Estate Investment Group
John Hancock Financial Services, Inc.

**John R. D'Eathe** (11/11)
West Vancouver, British Columbia 3,5
*President*
Freehold Development Canada Ltd.

**Rob P. Dexter,** QC (11/14)
Halifax, Nova Scotia 2,5
*Chairman and Chief Executive Officer*
Maritime Marlin Travel



**MGen. (Ret'd) M. Scott Eichel** (9/9)
Victoria, British Columbia 4
*President*
Eichel Aviation Services Inc.

**Ruth M. Grant** (12/13)
Toronto, Ontario 2,4
*President*
Craigellachie Holdings Ltd.

The bracketed numbers following each name indicate the total number of board and committee meetings which the director attended, followed by the number they were eligible to attend in the 12 months ended December 31, 2000. The numbers following the director's location indicate the board committee memberships.

1. Executive Committee
2. Audit Committee
3. Conduct Review and Corporate Governance Committee
4. Customer Issues Committee
5. Investment Committee
6. Human Resources Committee

**Lawrence J. Hayes,** QC (16/16)
Halifax, Nova Scotia 3,5,6
McInnes Cooper

**Jean C. Lavoie** (14/14)
Montreal, Quebec 2,4
Business Consultant

**Douglas G. MacKenzie** (12/17)
Oakville, Ontario 2,3,5
*President and CEO*
Pacific Rim Ethanol

**Robert J. Mair,** QC (13/13)
Vancouver, British Columbia 2,4
*Partner*
Lawson, Lundell, Lawson & McIntosh

**Thomas E. Moloney** (14/14)
Boston, Massachusetts 1,5,6
*Chief Financial Officer*
John Hancock Financial Services, Inc.

**Jocelyne Pelchat** (16/16)
Town of Mount Royal, Quebec 3,4,6
*President and CEO*
Entreprises Pelchat Moïse Inc.

**Anna Porter,** OC (9/9)
Toronto, Ontario 4
*Publisher and CEO*
Key Porter Books

**Robert R. Reitano** (14/14)
Boston, Massachusetts 2,5
*Senior Vice President and*
*Chief Investment Strategist*
John Hancock Financial Services, Inc.

**Dr. Tom Traves** (12/12)
Halifax, Nova Scotia 3,4
*President and Vice-Chancellor*
Dalhousie University

# Honourary Directors

**Andrew Eisenhauer**
Lunenburg, Nova Scotia

**Fraser M. Fell,** CM, QC
Toronto, Ontario

**Dr. Reva Gerstein,** OC
Toronto, Ontario

**John W. Lindsay, Sr.**
Dartmouth, Nova Scotia

**Arthur R. Lundrigan**
Corner Brook, Newfoundland

# Overview of Corporate Governance Practices

Good corporate governance is the foundation of a financially solid company and underpins the financial well-being of all Maritime Life stakeholders: - policyholders, shareholders, distribution partners and our employees. The corporate governance framework within which Maritime Life operates has allowed it to meet the evolving expectations of our stakeholders, insurance regulators and the investment community.

Highlights of the significant accomplishments of the Board of Directors and its Committees resulting from our corporate governance practices in 2000 included:

- The Human Resources Committee approved the implementation of a Leadership Development initiative. The Committee was active in overseeing the integration of our key Human Resources policies, including a new staff incentive plan and a pension governance model for the existing defined benefit and newly created defined contribution pension plans.
- The Investment Committee, as part of its annual review of the governance surrounding the prudent investment of assets, approved a revised Investment Policy Statement.
- The Conduct Review and Corporate Governance Committee approved a revised Conflict of Interest and Business Practices Policy for the Company, clarifying compliance with insider trading rules.
- The Customer Issues Committee, in addition to its regular work, approved the adoption of a Product Design and Pricing Risk Management Policy for each of the Retail Division and the Group Division and a Retail Underwriting and Liability Risk Management Policy. They also met with a number of our Group customers to hear first-hand about our customer satisfaction.
- The Audit Committee reviewed and approved a revised mandate for the Audit Committee, following consideration of the recommendations of the Blue Ribbon Committee on Audit Committee best practices. They also received the results of a peer review of the Company's policy valuation practices, including a separate review of the valuation practices for segregated fund guarantees.

**Mandate of the Board of Directors**

The Board of Directors supervises the management of the business of Maritime Life through its five scheduled meetings each year, with and without management present. The Board expects management to operate the company in a financially sound and ethical manner, fostering growth and profit, and to provide clear and concise information on the operations and proposed future actions. Annually, the Board reviews the business risks and risk management policies and practices of the Company. Key to the Board's supervision is the review and approval of strategic business and financial plans. In addition, the Board approves financial statements and appoints officers and external auditors.

**Composition of the Board of Directors**

The effectiveness of the Board is critical to the governance of the Company and the independence of its directors enhances this objective. Maritime Life looks for breadth of expertise in recruiting new directors, seeking a diversity of professional backgrounds and national representation.

The number of directors of the Company can range from 12 to 20 and at December 31, 2000, there were 18 directors. All directors, except the President and Chief Executive Officer, are independent of management. Maritime Life's common shares are owned by John Hancock Financial Services Inc. through a Canadian holding company, John Hancock Canadian Holdings Limited. Four senior officers of John Hancock are actively involved on the Company's Board and shareholder feedback is provided in this manner. All Board members are provided with a frequently updated orientation binder to inform them of evolving insurance industry and corporate matters.

**Committees of the Board**

The Board is assisted in fulfilling its responsibilities through the use and work of committees. Committees of the Board are generally composed of unrelated directors, with the exception of the Executive Committee. The Executive Committee acts on behalf of the Board in connection with Company business between meetings of the Board of Directors. The Investment Committee manages the investing and lending of the funds of the Company in accordance with prudent investment policies and the provisions of the Insurance Companies Act of Canada. The Conduct Review and Corporate Governance Committee monitors related party transactions and reviews the corporate governance functions of the Company, including directors' compensation. The Customer Issues Committee reviews marketing strategies, market conduct and customer satisfaction levels and approves the dividend scale for participating policies. The Audit Committee's mandate is to review the Company's internal controls, accounting, auditing and reporting practices, and the adequacy of financial disclosure to policyholders and shareholders for both the general funds of the Company and its segregated funds. The Human Resources Committee approves compensation for employees of the Company, recommends appointment of senior officers and advises management on human resource related issues.

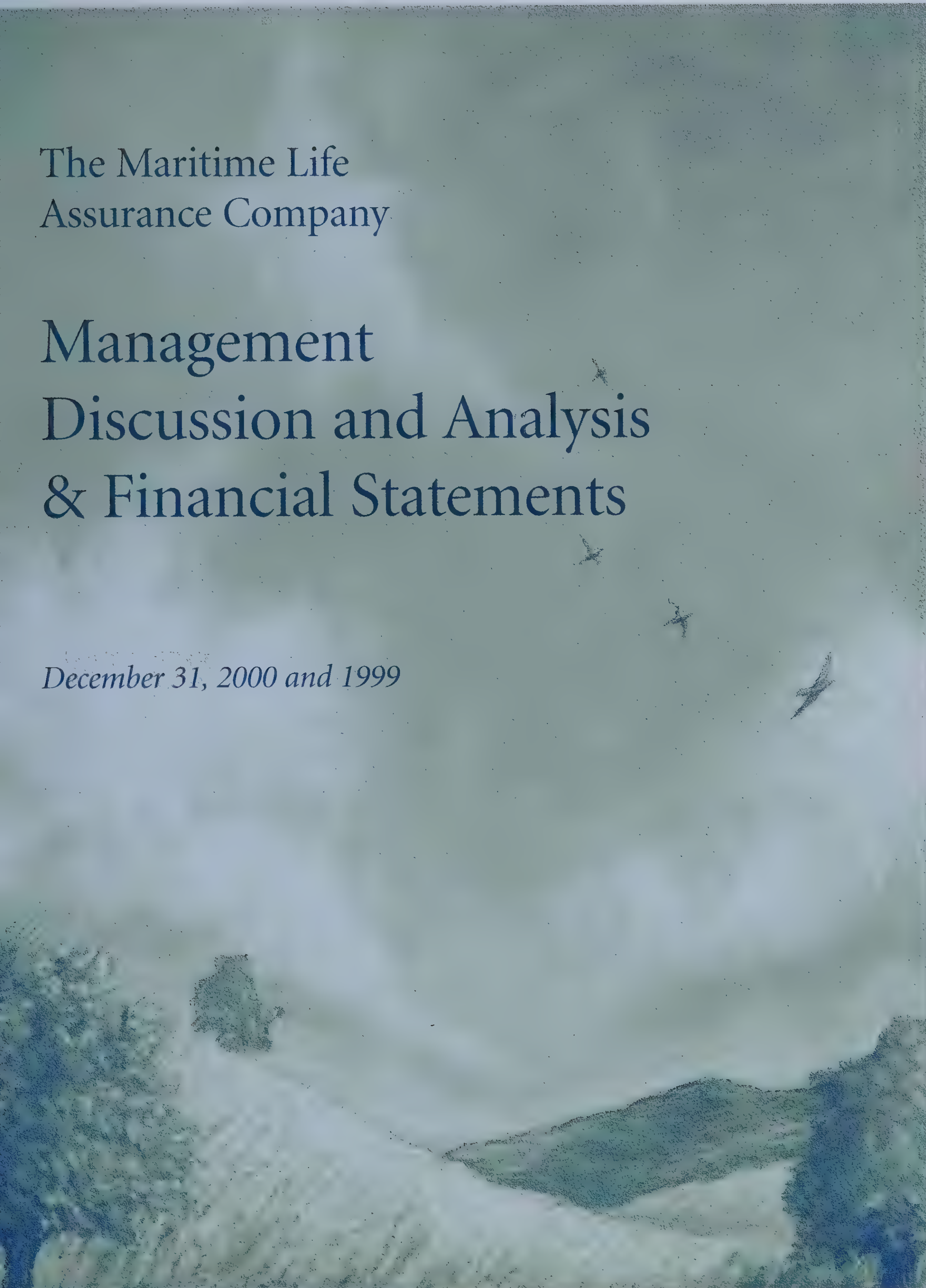
## Corporate Structure

| Principal Subsidiaries | Address | Beneficial Ownership | Book Value of Capital Stock ($000's) |
|---|---|---|---|
| Landex Properties Limited | Vancouver, B.C. | 100 % | $ 2,400 |
| Eclipse Claims Services Inc. | Toronto, Ont. | 25 % | – |
| Churchill Office Park Limited | Toronto, Ont. | 45 % | – |
| PVS Preferred Vision Services Inc. | Toronto, Ont. | 20 % | 200 |
| Financial Life Assurance Company of Canada | Toronto, Ont. | 100 % | nil |
| Canadian Corporate Health Solutions Inc. | Toronto, Ont. | 100 % | nil |
| CIFAS Investment Corporation | Halifax, N.S. | 100 % | nil |

The Maritime Life
Assurance Company

# Management Discussion and Analysis & Financial Statements

*December 31, 2000 and 1999*



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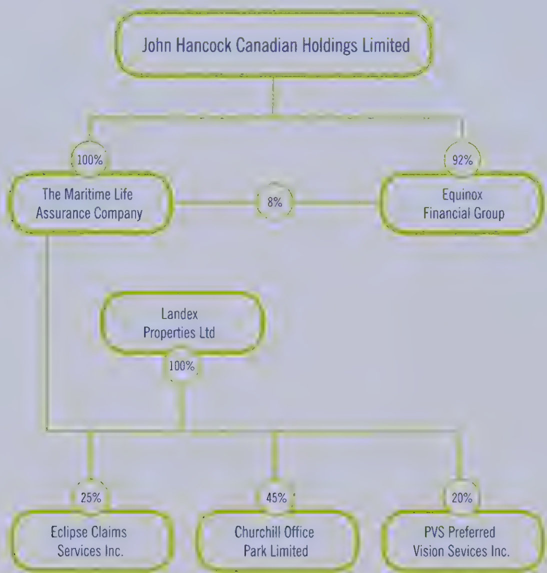
# Corporate Organization



# Management's Discussion & Analysis

Management's Discussion & Analysis (MD&A) presents management's view of the financial position and performance of The Maritime Life Assurance Company ("Maritime Life" or the "Company") for the year ended December 31, 2000 compared with 1999. The MD&A should be read in conjunction with the information disclosed within the annual consolidated financial statements and notes to those consolidated financial statements as determined using Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). The MD&A provides an overall discussion, followed by analysis of the performance of the Company's major reportable segments.

## Overview

We are a financial services company, providing individual life insurance and living benefits, investment products, pensions, and group life and health products and services. We operate through two divisions: the Retail division, comprised of life, disability and investment products including group pensions and the Group division, comprised of group life, accident and sickness benefits.

## Financial Results in Summary

The Company reported consolidated shareholders' net income of $85.9 million for 2000 compared to $36.2 million for 1999, a year over year increase of 137.0%.

Most of this increase was from the recognition of expense and tax synergies resulting from the acquisition of Aetna Canada, which is not expected to be a continuing result.

Pre-tax operating income before unusual items, income taxes and goodwill amortization was 42.8% ahead of 1999's result.

In the Retail division, our traditional life products, including universal life, had pre-tax operating profit of $122.7 million, 33.5% better than 1999. Significant synergies in the areas of expenses and taxes were achieved in 2000 following the amalgamation of Aetna Life with Maritime Life on January 1, 2000. While the direct cash impact of these synergies will be spread over many years, the standards for determining Canadian GAAP policy liabilities require that the impact of all future cash flows be considered. Accordingly, we have reported in policy liabilities determined at December 31, 2000 the impact of the synergies that will be manifested over the future life of the inforce policies.

Our investment products business shows pre-tax operating profit of $35.9 million, up 7.2% from 1999. Our individual disability and critical illness line had pre-tax operating profit of $13.5 million, up 11.3% from 1999 levels.

Pre-tax operating profit on group insurance rebounded from 1999 by $22.4 million, primarily due to lower supplementary health and long-term disability claims and long-term disability reinsurance arrangements implemented on the Aetna Canada block at the beginning of the year.

We continued to enjoy excellent credit loss recoveries on investment principal in 2000, with $5.5 million of net recoveries compared to a favourable year in 1999 that showed only $3.5 million of credit losses. This trend is consistent with the favourable credit environment in the economy generally.

Unusual items for 2000 include integration costs of $14.9 million partially offset by a gain from pension conversion of $3.4 million. Integration costs will continue to be incurred in 2001 as we complete the balance of the integration projects. Using "continuity of interest accounting" *(see note 3 to the consolidated financial statements)* the comparative balance for unusual items included substantial sale costs for Aetna Canada incurred prior to the acquisition such as winding up existing incentive compensation plans and closing subsidiaries.

The Company's consolidated risk based capital ratio, defined by the Office of the Superintendent of Financial Institutions (OSFI) as Minimum Continuing Capital and Surplus Requirements (MCCSR), continued to be well in excess of the minimum supervisory requirement of 150% and was 192% as at December 31, 2000.

Total assets under administration, including segregated fund assets, are $11.5 billion, up 8.7% in the year. The segregated fund products, managed separately from the general fund business, generated most of this growth.

*Ratings*

*Our financial and fiscal strength is monitored by external rating agencies. Favourable ratings give comfort to our policyholders, customers and investors that the Company is prudently managed.*

*Claims Paying Ability*

| Rating Agency | Rating | Rating Description |
|---|---|---|
| A.M. Best | A+ | Superior |
| Moody's | A1 | Good financial security |
| CBRS | A+(low) | Very good quality |
| DBRS | IC-2 | Satisfactory credit quality |

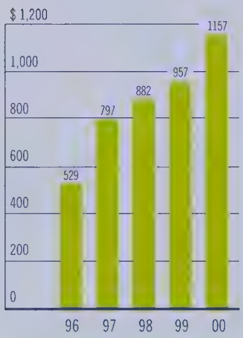
*Cumulative preferred shares: (1986 issue – MMF.PR.A)*

| Rating Agency | Rating | Rating Description |
|---|---|---|
| CBRS | P-2 | Very good credit quality |
| DBRS | Pfd-2 | Satisfactory credit quality |

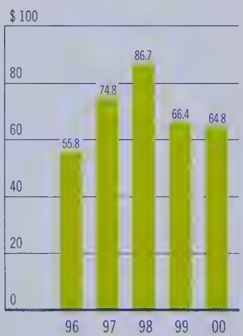
*Non-cumulative preferred shares: (1999 issue – MMF.PR.B)*

| Rating Agency | Rating | Rating Description |
|---|---|---|
| CBRS | P-2 (low) | Good credit quality |
| DBRS | Pfd-2 n | Satisfactory credit quality |

## New IP Deposits
*(millions of dollars)*




## Life Insurance New Sales
*(millions of dollars)*




## QUARTERLY RESULTS
*(unaudited, in millions)*

| | 2000 | | | | 1999 | | | |
|---|---|---|---|---|---|---|---|---|
| | 4Q | 3Q | 2Q | 1Q | 4Q | 3Q | 2Q | 1Q |
| Revenue | $ 402.1 | $ 456.8 | $ 458.4 | $ 477.7 | $ 526.9 | $ 430.2 | $ 446.3 | $ 425.4 |
| Net income to shareholders | $ 52.2 | $ 17.0 | $ 11.3 | $ 5.3 | $ 15.9 | $ (1.4) | $ 10.2 | $ 11.5 |

Improved profitability in the fourth quarter is primarily attributable to the group life and health segment and recognition of the expense and tax synergies achieved in 2000.

## Retail Division

Our Retail division continues to support independent distribution of its products. Our distribution network consists of independent agents, managing general agencies, national accounts, and partnerships and alliances with mutual fund distributors. Complementing these distribution channels, our affiliate, Equinox Financial Group, offers financial planning products and services through a network of independently owned marketing centres and associate financial advisors.

The acquisition of Aetna Canada in 1999 has rounded out our product line by adding individual disability products, enhancing the ability of our distributor network to offer a complete line of products to our customers.

### Investment Products

Our investment product sales, consisting of segregated fund products and guaranteed investment products and annuities continued its steady growth, with new deposits of $998.3 million compared to $864.8 million in 1999, up 15.4%. Of the new deposits, 94.5% represents segregated funds compared to 94.4% in 1999. The Investment Funds Institute of Canada has reported that mutual fund gross sales for 2000 were up 12.8% from the level reported in 1999. Our Group pension sales are 71.9% above 1999 levels.

Segregated fund products appeal to customers seeking more protection than offered by traditional mutual funds. Available only from insurance companies, segregated funds provide the benefits of mutual funds with capital protection options, including guarantees at death and maturity, creditor protection and probate bypass. Given the current low interest rate environment, we expect demand for our segregated funds to continue to grow.

Segregated fund assets are $4.7 billion, up 16.3% from 1999.

During 2000 we offered 36 retail segregated funds, including 16 Partnership Series options within our strategic alliances with four of Canada's leading mutual fund companies – Talvest Fund Management, AGF Management Limited, Global Strategy Financial Inc. and Fidelity Investments Canada Limited. We also offer 5 funds under the "Synchrony Funds" brand, an alliance with Talvest Fund Management.

### Life Insurance

Individual life products include our universal life products, Intrepid and Architect, which both offer flexible investment options. We also offer more traditional whole and term life products. Individual life sales, measured by annualized premium, were $64.8 million for 2000, down 2.4% from our result of $66.4 million for 1999. An intensely competitive environment and the evolving trends to more standard underwriting classes, called preferred classes, influenced this sales result. Also, our sales focus was tempered in 2000 as we concentrated on integration activities with the operations of Aetna Canada.

### Living Benefits

Living Benefits include individual critical illness and disability insurance products. These products help individuals protect their financial security against unexpected events or illnesses such as heart attack and stroke. Living Benefit sales, also measured by annual premium, were $7.6 million in 2000, quite comparable to the $8.5 million result in 1999.

We recently introduced Critical Needs, a new critical illness insurance product, to our Living Benefits product line. This product

provides lump-sum benefits to seriously-ill policyholders to help offset medical expenses or provide extra funds in those times of severe stress due to illness. We expect that this product will quickly become a significant source of Living Benefits growth.

### Group Division

Our Group division, recognizing the significant amount of effort that integration of the Aetna Canada Group operations would entail, strategically decided to focus their efforts on maintaining excellent customer service rather than pursue additional new business in 2000. Accordingly, new sales were $166.0 million compared to $212.6 million in 1999. This strategy has been rewarded with excellent customer retention rates and increased profitability.

### Operations

Revenue premium was $1,244.0 million in 2000, up 3.2% from $1,205.4 million in 1999. This represents a 1.2% increase in revenue premium relating to life insurance products, (2.1)% for individual disability and 8.8% for group premium. Net deposits of guaranteed investment products of $29.0 million, down 49.6% from 1999, are also reflected within revenue premium and demonstrate policyholder preferences for segregated funds.

Investment income was $421.5 million, down 17.5% from 1999. This result primarily reflects swings in a volatile market environment for equities in 2000, substantially on behalf of our universal life policyholders. The positive credit environment experienced in 1999 continued in 2000, resulting in net credit recoveries of $5.5 million during the year.

Other income increased by 14.8% to $129.4 million in 2000 primarily due to management fees from growth in our segregated fund business.

We paid $1.0 billion in policyholder benefits and dividends to policyholders in 2000, down 4.1% from 1999. In addition, we set aside $43.3 million in reserves for future policy benefits, ensuring the protection our policyholders purchased is available when they need it.

Commissions and operating expenses, including premium and investment income taxes were $411.4 million in 2000, down $12.9 million or 3.0% from 1999. New sales growth and excellent persistency resulted in commission expenses that were 4.7% higher than 1999. Operating expenses alone were 15.8% lower than 1999 as expense synergies resulting from the acquisition began to be realized. Also affecting operating costs, in 2000 we changed our accounting policy for internal-use software development to capitalize certain of our technology development costs where those costs are likely to bring substantial value to the Company's operations over a lasting period of time. Accordingly, we have capitalized $8.6 million of current technology development costs that will benefit future periods.

On December 21, 2000, the Federal Government tabled proposed legislative changes announced in the October mini-budget. Due to the presence of a majority government, accounting convention permits the substantially enacted corporate income tax rate reductions to be used to calculate future taxes payable. Accordingly, income tax expense for the year reflects a significantly reduced effective tax rate of 35.7%, down 8.0% from the effective tax rate in 1999.

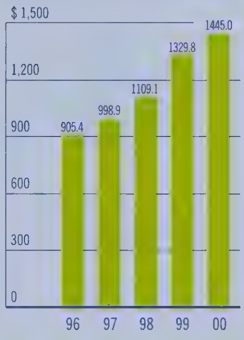
### Integration

The acquisition of Aetna Canada in the fall of 1999 and its subsequent integration with Maritime Life resulted in integration costs incurred in 1999 of $4.7 million and $14.9 million in 2000. The 1999 income statement also reflects pre-acquisition costs related to the sale of Aetna Canada of $39.6 million due to the continuity of interest basis of accounting required to account for the acquisition *(see note 3 to the consolidated financial statements)*. We expect to spend approximately $13.0 million in 2001 as we complete the integration projects currently underway.

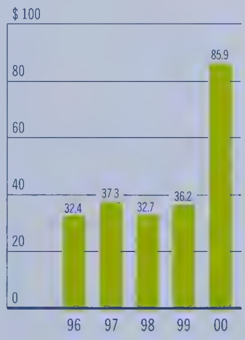
### Technology

The objectives of our technology plans are to provide superior customer service and efficient support. In 2000 we spent $5.7 million on projects to enhance our technological capabilities, excluding systems projects related to the integration with Aetna Canada. We will continue to invest in new technological

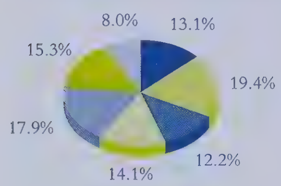
**Inforce Group Insurance Premiums and Premium Equivalents**
*(millions of dollars)*




**Net Income**
*(millions of dollars)*

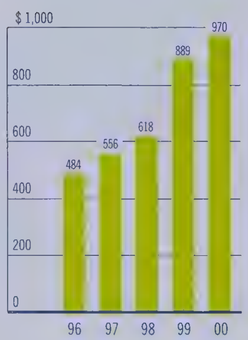


**General Fund Investment Mix**




- Canada Mortgage and Housing Corporation
- Government bonds
- Private placement bonds
- Conventional mortgages
- Corporate bonds
- Equities, real estate and short-term investments
- Other

**Capital and Surplus**
*(millions of dollars)*




capability, primarily related to web-enabled delivery of information and efficient support systems. We expect to spend similar amounts in future periods.

## FINANCIAL POSITION

The General Fund assets of the Company exceeded $6.8 billion dollars, up 4.1% from 1999. We have made good progress in re-balancing our asset mix following the Aetna Canada acquisition but there remains some further re-balancing to maximize our investment return within prudent limits.

Our current asset mix is depicted in the pie chart opposite. Our investment risk is mitigated through diversification of asset type, geographical locale and industry sector. Major groups of investments in our general fund are:

- Canada Mortgage and Housing Corporation (CMHC) government-insured mortgages (13.1%; 1999 – 10.6%) – cover residential developments in cooperation with the Government of Canada and private developers, providing housing to Canadians across the country.
- Government bonds (19.4%; 1999 - 22.9%) – represent obligations of federal and provincial entities across Canada. Government bonds generally have excellent credit ratings and are highly liquid. The combination of government-insured mortgages and government bonds means over 32% of assets are backed by the strength of the federal and provincial governments of Canada.
- Private placement bonds (12.2%; 1999 – 11.0%) – represent investments throughout the North American economy. The portfolio is diversified by industry sector including power generation, manufacturing, transportation and non-fashion retail holdings in order to reduce risk. These types of bonds are typically funded by a small group of institutional investors and are not widely bought and sold, as is the case for publicly traded bonds.
- Conventional mortgages (14.1%; 1999 - 14.2%) – provide financing for real estate in office buildings, retail outlets, warehouse operations and residential developments.
- Corporate bonds (17.9%; 1999 – 18.5%) – are publicly traded and provide good diversity and liquidity.
- Equities, real estate and short-term investments (15.3%; 1999 – 14.6%) – most of the equities match the equity-linked options we offer to universal life policyholders.

Invested assets represent 92.0% of the total assets; non-invested assets such as premiums receivable, policy loans and goodwill account for the remaining $550.4 million.

## CAPITAL AND LIQUIDITY

Total shareholders' equity was $738.7 million, up 11.4% from 1999. Our capital structure reflects a mix of forms of capital available to financial institutions, optimizing our cost of capital while providing security to our policyholders.

OSFI sets guidelines for MCCSR for Canadian life insurers. As at December 31, 2000, we held eligible capital and surplus at a level equal to 192% (1999 – 182%; 1998 – 193%) of the required minimum. The Company has a policy of maintaining its capital and surplus at a level between 175% – 200% of the required minimum and monitors industry capital levels to assess the ongoing appropriateness of this level.

It is important that any financial institution has access to cash to make policy benefit and expense payments as they come due. Sources of liquidity include readily marketable assets such as government bonds, public bonds and preferred shares as well as cash and lines of credit. The risk of illiquidity increases if principal and interest cash flows related to assets, liabilities and off-balance sheet items are mismatched.

The Company has established a strategic liquidity plan for maintaining a sufficient level for short-term and long-term highly marketable securities to meet unexpected and adverse business conditions. Operating liquidity is maintained by ensuring an

adequate cash flow is obtained from the Company's sources of funding – its premium and investment income, an operating cash float and bank overdraft facilities.

## RISK MANAGEMENT

The Company faces a variety of risks in conducting its businesses. Management has developed policies and procedures to enable it to respond to these risks. The Board of Directors approves the Company's overall risk management policies. Policies relating to product design and pricing are approved by the Appointed Actuary, the Chief Financial Officer and the Chief Executive Officer. The Customer Issues Committee reviews policy retention limits and reinsurance limits. The Investment Committee reviews policies covering the investment risks, including asset mix, credit risk, interest rate risk, asset liability matching and liquidity risk. The Audit Committee reviews overall internal controls as well as general and commercial insurance coverages. The Human Resources Committee reviews all staffing and compensation policies. The Conduct Review and Corporate Governance Committee reviews the regulatory and risk management compliance processes used by the Company.

Compliance with policies is monitored at defined intervals by the Company's compliance officer and internal and external auditors, and is reviewed periodically by OSFI.

### Pricing Risk

Pricing involves estimates and assumptions of such factors as mortality, morbidity, future investment yields, expenses and surrenders. Pricing risk is the risk that actual experience will not develop as estimated in pricing. Management of pricing risk includes careful product design, extensive use of modeling and sensitivity testing as well as monitoring through experience studies.

For new Retail products the Appointed Actuary and the Chief Financial Officer review the actuarial assumptions, design and methodology. The Senior Vice-President, Retail Marketing reviews the marketing opportunity and sales outlook for new products, the Senior Vice-President, Retail Services reviews the administration capacity and the Chief Investment Officer reviews the investment aspects. The Chief Executive Officer provides the final approval for the product introduction. Profit emergence is compared against pricing assumptions periodically and remedial action can include redesign, re-pricing of new and future policies or adjustment to asset/liability matching strategies.

Risk management for new products in the Group Division focuses on review of actual experience against inter-company studies. Pricing of new and renewal business is adjusted according to emerging trends.

### Claims Risk

Claims risk is the risk that actual mortality and morbidity experience exceeds underwriting expectations. The Company manages its claims risk through comprehensive underwriting and claims payment guidelines.

Reinsurance is used to mitigate excessive exposure to individual lives or benefits. The Company's maximum retentions, established separately for individual life, living benefits, group life and group health are subject to Board approval.

### Product Performance Guarantees

The Company guarantees minimum rates of return with respect to the savings elements of adjustable and universal life insurance policies. For segregated funds, the Company also guarantees minimum proceeds on the maturity date of a policy or the earlier death of the annuitant.

Risk management for product guarantees includes revision of product features for future new issues, and adjustments to policy charges on existing policies where contract terms allow. For segregated funds' guarantees, the product design and marketing focus have produced a widely dispersed maturity date profile that provides diversification and risk mitigation. The Company regularly monitors its exposure to these guarantees and measures their costs and risk under a wide range of persistency and future fund performance scenarios.

### Interest Rate Risk

The Company's financial position may be affected by its exposure to interest rate risk. Interest rate risk is the risk of economic losses or gains arising from the reinvestment of cash flows or lack of reinvestment. If the assets supporting the policy liabilities do not match the timing and amount of the policy obligations, interest rate losses or gains may occur due to changing interest rates in the future. The Company has an asset/liability management program that seeks to achieve an effective match. The quality of the asset/liability matching program is addressed quarterly using duration measures and cash flow testing under alternative economic scenarios.

### Credit Risk

Credit risk is the exposure to loss in the event of non-performance or failure of an investment. Exposure to credit loss is managed through compliance with investment policy standards for quality ratings, maximum single issuer guidelines, diversification of type and location of properties and, for mortgages and real estate, independent borrower and appraisal reviews. Compliance is measured frequently and reported to the Investment Committee of the Board quarterly.

### Market Risk

Market risk is the exposure to investment loss from general economic and stock market fluctuations. The Company's asset mix guidelines identify limits on the amount and quality of equity investments. Compliance with this limitation is measured constantly and reported to the Investment Committee of the Board quarterly.

### Derivative Instruments

The Company uses derivative financial instruments where appropriate in the administration of its asset/liability management strategies and to assist in the management of financial risk, including interest rate and foreign exchange risks. All of the Company's derivative financial instruments are held for hedging purposes, not for speculation. Financial institution counterparties for the Company's derivative activities are rated AA or better by independent rating agencies.

### Other Operational Risks

The Company is exposed to other operational risks including legal, regulatory, human resources, tax, technology, outsourcing and market conduct risks. Senior management develops risk identification and monitoring procedures to manage these risks. Operating management is responsible for implementing these procedures. Internal auditors review the effectiveness of the internal controls and report quarterly to the Chief Executive Officer and the Audit Committee.

For additional information on risks and our risk management practices, reference is made to Notes 7, 9, 10, and 23 in the consolidated financial statements.

# The Maritime Life Assurance Company

# Consolidated Financial Statements

## December 31, 2000 and 1999

## Responsibility for Financial Reporting

### Management

The accompanying consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. The consolidated financial statements necessarily include amounts that are based on management's best estimates and judgment. These consolidated financial statements fairly reflect the financial position and results of operations of the Company within reasonable limits of materiality.

In carrying out its responsibilities, management maintains appropriate systems of internal and administrative controls, consistent with reasonable cost, designed to ensure that the financial information produced is relevant and reliable and that the Company's assets are appropriately accounted for and adequately safeguarded.

### Board of Directors

As required by the Insurance Companies Act, the consolidated financial statements were approved by the Board of Directors which has overall responsibility for their content.

### Audit Committee

The Board of Directors is assisted in its responsibility by its Audit Committee, which consists entirely of Directors not involved in the daily operations of the Company, the majority of whom are not affiliated with the Company. The function of the Audit Committee is to:

- review the annual consolidated financial statements of the Company before they are approved by the Board of Directors; require the management of the Company to implement and maintain appropriate internal control procedures; review such investments and transactions that could adversely affect the well-being of the Company as the External Auditor, Internal Auditor or any officer of the Company may bring to the attention of the Committee;
- meet with the External Auditor to discuss the annual consolidated financial statements and transactions as required;
- meet with the Appointed Actuary of the Company to discuss the parts of the Annual Statement prepared by the Appointed Actuary;
- meet with the Internal Auditor of the Company and with management of the Company to discuss the effectiveness of the internal control procedures established for the Company;
- report to the Board of Directors on the review of the annual consolidated financial statements before approval of the Board of Directors is given.

In carrying out this function, the Committee meets with management to review the decisions made in preparing the financial statements and meets with both the Company's external and internal auditors to approve the scope and timing of the respective audits, to review their findings, and to satisfy itself that the audit responsibilities have been properly discharged.

**The Appointed Actuary**

- is appointed by the Board of Directors.
- is responsible for ensuring that the assumptions and methods used in the valuation of policy liabilities are in accordance with accepted actuarial practice, applicable legislation and associated regulations or directives.
- is required to provide an opinion regarding the appropriateness of the policy liabilities as at the consolidated balance sheet date to meet all policyholder obligations of the Company. Examination of supporting data for accuracy and completeness and analysis of Company assets for their ability to support the amount of policy liabilities are important elements of the work required to form this opinion.
- is required each year to analyze the financial condition of the Company and prepare a report for the Board of Directors. The analysis tests the capital adequacy of the Company until December 31, 2005 under adverse economic and business conditions.

**External Auditors**

KPMG LLP have been appointed external auditors pursuant to Section 337 of the Insurance Companies Act to report to the policyholders, shareholders and to the Office of the Superintendent of Financial Institutions Canada regarding the fairness of presentation of the Company's financial position and results of operations as shown in the annual consolidated financial statements. Their report appears with these consolidated financial statements.

W.A. Black

William A. Black

President and
Chief Executive Officer

Philip J. Pothier

Senior Vice-President
and Chief Financial
Officer

# Auditors' Report

*To the policyholders and shareholders of The Maritime Life Assurance Company.*

We have audited the consolidated balance sheets of The Maritime Life Assurance Company as at December 31, 2000 and 1999 and the consolidated statements of income, retained earnings, participating account, cash flows and changes in segregated fund assets for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2000 and 1999 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles including the accounting requirements of the Superintendent of Financial Institutions Canada.

KPMG LLP

Chartered Accountants
Halifax, Canada
January 19, 2001

# Appointed Actuary's Report

*To the policyholders and shareholders of The Maritime Life Assurance Company.*

I have valued the policy liabilities of The Maritime Life Assurance Company for its consolidated balance sheets at December 31, 2000 and 1999 and their change in the consolidated statements of income for the years then ended in accordance with accepted actuarial practice, including selection of appropriate assumptions and methods.

In my opinion, the amounts of the policy liabilities make appropriate provision for all policyholder obligations and the consolidated financial statements fairly present the results of the valuations.

Byron Corner

Byron Corner
Fellow, Canadian Institute of Actuaries
Halifax, Canada
January 19, 2001

# Consolidated Balance Sheets

*as at December 31, 2000 and 1999*
*(In thousands of dollars)*

| | 2000 | 1999 |
|---|---|---|
| **Assets** | | |
| Invested assets *(note 4)* | | |
| Bonds | $ 3,387,972 | $ 3,441,668 |
| Government insured mortgages | 893,594 | 693,930 |
| Conventional mortgage | 965,048 | 936,319 |
| Equities | 667,203 | 569,463 |
| Real estate | 129,694 | 135,297 |
| Short-term investments | 250,785 | 258,026 |
| | 6,294,296 | 6,034,703 |
| Other assets | | |
| Premiums receivable | 71,212 | 64,839 |
| Policy loans | 95,994 | 94,641 |
| Accrued investment income | 53,303 | 56,404 |
| Goodwill, net *(note 3)* | 135,973 | 151,666 |
| Other *(note 6)* | 193,871 | 175,393 |
| | 550,353 | 542,943 |
| | $ 6,844,649 | $ 6,577,646 |
| Segregated fund assets under management | $ 4,664,155 | $ 4,008,703 |

| | 2000 | 1999 |
|---|---|---|
| **Liabilities, Participating Account and Shareholders' Equity** | | |
| Policy liabilities *(notes 9 and 10)* | | |
| Provision for future policy benefits | $ 4,910,645 | $ 4,861,148 |
| Provision for experience rating refunds | 60,155 | 66,998 |
| Provision for policyholders' dividends | 20,459 | 11,943 |
| Policyholders' funds on deposit | 314,076 | 271,249 |
| Benefits payable and provision for unreported claims | 101,175 | 108,733 |
| Notes payable to reinsurers *(note 11)* | 92,789 | 100,794 |
| | 5,499,299 | 5,420,865 |
| Future and deferred income taxes *(note 19)* | 82,460 | 32,668 |
| Deferred net gains *(note 12)* | 39,228 | 35,280 |
| Other *(note 13)* | 254,042 | 199,402 |
| | 5,875,029 | 5,688,215 |
| Subordinated debt *(note 14)* | 176,000 | 176,000 |
| Participating account *(note 15)* | 54,876 | 49,990 |
| Shareholders' equity: | | |
| Share capital *(note 16)* | 185,851 | 185,851 |
| Contributed surplus | 441,203 | 441,203 |
| Retained earnings | 111,690 | 36,387 |
| | 969,620 | 889,431 |
| | $ 6,844,649 | $ 6,577,646 |

Contingent liabilities and commitments – *see Notes 23 and 24*
*See accompanying notes to financial statements*

On behalf of the Board:

J.D. Crawford
Chairman of the Board

W.A. Black
President and Chief Executive Officer

# Consolidated Statements of Income

*Years ended December 31, 2000 and 1999*
*(In thousands of dollars)*

| | 2000 | 1999 |
|---|---|---|
| Revenue | | |
| Premiums *(note 10)* | $ 1,244,007 | $ 1,205,412 |
| Investment income *(note 17)* | 421,526 | 510,669 |
| Other income | 129,407 | 112,700 |
| | 1,794,940 | 1,828,781 |
| Policy benefits and expenses | | |
| Policy benefits *(note 10)* | 1,012,011 | 1,066,027 |
| Provision for future policy benefits | 43,326 | 85,412 |
| Transfer to segregated funds | 106,931 | 97,518 |
| Commissions and operating expenses *(note 10)* | 369,737 | 389,108 |
| Dividends to policyholders | 24,410 | 15,010 |
| Premium and investment income taxes | 41,657 | 35,146 |
| Interest on notes payable *(note 11)* | 8,741 | 8,883 |
| Interest on subordinated debt *(note 14)* | 12,778 | 8,908 |
| | 1,619,591 | 1,706,012 |
| Operating income before the undernoted | 175,349 | 122,769 |
| Unusual items *(note 18)* | (11,543) | (38,648) |
| Income before income taxes and goodwill amortization | 163,806 | 84,121 |
| Income taxes *(note 19)* | (58,452) | (36,080) |
| Income before goodwill amortization | 105,354 | 48,041 |
| Goodwill amortization *(note 3)* | (14,600) | (1,524) |
| Undistributed participating policyholders' income | (4,886) | (10,287) |
| Net income to shareholders *(note 20)* | $ 85,868 | $ 36,230 |

Earnings per common share *(note 21)*
*See accompanying notes to financial statements*

# Consolidated Statements of Retained Earnings

*Years ended December 31, 2000 and 1999*
*(In thousands of dollars)*

| | 2000 | 1999 |
|---|---|---|
| Balance, beginning of year | $ 36,387 | $ 186,395 |
| Change in accounting policies *(note 2)* | (2,645) | — |
| Balance, beginning of year as restated | 33,742 | 186,395 |
| Net income to shareholders | 85,868 | 36,230 |
| Pre-acquisition earnings transferred to contributed surplus *(note 3)* | — | (922) |
| Dividends to shareholders: | | |
| Preferred | (7,920) | (2,316) |
| Common | — | (183,000) |
| Balance, end of year | $ 111,690 | $ 36,387 |

*See accompanying notes to financial statements*

# Consolidated Statements of Participating Account

*Years ended December 31, 2000 and 1999*
*(In thousands of dollars)*

| | 2000 | 1999 |
|---|---|---|
| Balance, beginning of year | $ 49,990 | $ 32,861 |
| Revaluation adjustment *(note 3)* | — | 6,842 |
| Undistributed participating policyholders' income | 4,886 | 10,287 |
| Balance, end of year | $ 54,876 | $ 49,990 |

*See accompanying notes to financial statements*

# Consolidated Statements of Cash Flows

*Years ended December 31, 2000 and 1999*
*(In thousands of dollars)*

| | 2000 | 1999 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net income to shareholders | $ 85,868 | $ 36,230 |
| Items not involving cash: | | |
| Realized investment gains, net | (11,774) | (3,597) |
| Amortization and depreciation | (7,255) | (92,267) |
| Net provisions and write-offs for impaired invested assets | (1,174) | (9,636) |
| Interest capitalized on invested assets | (5,534) | (5,125) |
| Interest credited to policyholders' funds on deposit | 16,728 | 18,125 |
| Future and deferred income taxes | 49,792 | 23,719 |
| Increase in policy liabilities | 61,706 | 112,578 |
| Increase in premiums receivable | (6,312) | (260) |
| Decrease (increase) in accrued investment income | 3,101 | (3,127) |
| Decrease in other, net | 37,422 | 6,348 |
| Cash flows from operating activities | 222,568 | 82,988 |
| **Cash flows used for investing activities** | | |
| Sales, maturities, prepayments and scheduled redemption of: | | |
| Invested assets *(note 27)* | 1,626,430 | 1,099,130 |
| Policy loans | 17,183 | 18,528 |
| Purchase / issue of: | | |
| Invested assets *(note 27)* | (1,862,354) | (1,122,718) |
| Policy loans | (14,371) | (15,003) |
| Other | — | (6,573) |
| Property and equipment | (10,390) | (4,642) |
| Cash flows used for investing activities | (243,502) | (31,278) |
| **Cash flows from (used for) financing activities** | | |
| Issue of subordinated debt | — | 106,000 |
| Redemption of subordinated debt | — | (30,329) |
| Issue of second preferred shares | — | 100,000 |
| Contributed surplus | — | 14,000 |
| Share issue costs | — | (2,894) |
| Dividends paid | (7,920) | (185,316) |
| Cash flows from (used for) financing activities | (7,920) | 1,461 |
| Increase (decrease) in cash and cash equivalents | (28,854) | 53,171 |
| Cash and equivalents, beginning of year | 209,375 | 156,204 |
| Cash and equivalents, end of year *(note 27)* | $ 180,521 | $ 209,375 |

*See accompanying notes to financial statements*

# Consolidated Statements of Changes in Segregated Fund Assets

*Years ended December 31, 2000 and 1999*
*(In thousands of dollars)*

| | 2000 | 1999 |
|---|---|---|
| Segregated fund assets, beginning of year | $ 4,008,703 | $ 3,062,028 |
| Increase during the year | | |
| Amounts received from policyholders | 2,441,213 | 1,949,062 |
| Amounts transferred to the General Fund | (10,935) | (58,746) |
| Interest income | 100,222 | 86,813 |
| Dividends | 28,627 | 34,056 |
| Net realized gain on sale of investments | 202,170 | 277,577 |
| Net unrealized increase (decrease) in market value of investments | (259,300) | 117,516 |
| | 2,501,997 | 2,406,278 |
| Decrease during the year | | |
| Amounts withdrawn by policyholders | (1,679,554) | (1,328,749) |
| Management fees and other operating costs | (92,285) | (74,986) |
| Distributions paid | (74,706) | (55,868) |
| | (1,846,545) | (1,459,603) |
| Segregated fund assets, end of year | $ 4,664,155 | $ 4,008,703 |
| | | |
| Segregated fund assets consist of: | | |
| Cash and short-term investments | $ 934,945 | $ 1,288,051 |
| Bonds | 649,843 | 470,191 |
| Mortgages | 477 | 521 |
| Equities | 2,331,363 | 1,936,413 |
| Units of other funds | 747,527 | 313,527 |
| | $ 4,664,155 | $ 4,008,703 |

*See accompanying notes to financial statements*

# Notes to Consolidated Financial Statements

*Years ended December 31, 2000 and 1999*
*(in thousands of dollars)*

The Maritime Life Assurance Company (the "Company") is continued under the Insurance Companies Act. It operates in the Canadian financial services industry and operations cover the development and marketing of individual life and savings, group life and health, and pension funds.

The Company is subject to regulation by the Office of the Superintendent of Financial Institutions Canada ("OSFI"). Under regulations and guidelines prescribed by OSFI, the Company is required to maintain prescribed levels of capital which are dependent on the type and amount of insurance policies in force and the nature of the Company's assets. The Company currently exceeds these minimum capital requirements. OSFI governs the distribution of the Company's earnings through monitoring of adherence to prescribed capital requirements.

## 1 Significant accounting policies and basis of presentation

### Basis of presentation

These consolidated financial statements have been prepared in accordance with Subsection 331(4) of the Insurance Companies Act which states that, except as otherwise specified by OSFI, the financial statements are to be prepared in accordance with generally accepted accounting principles and include the accounts of its wholly owned subsidiary Landex Properties Ltd. The comparative period included the accounts of its wholly-owned subsidiaries: Aetna Life Insurance Company ("Aetna Life") and Aetna Acceptance Corporation Limited ("Aetna Acceptance"), both of which were amalgamated with The Maritime Life Assurance Company on January 1, 2000 and carry on business under the name The Maritime Life Assurance Company (the "Company").

The significant accounting policies used in the preparation of these financial statements, including the accounting requirements of OSFI, are summarized below. These accounting policies conform, in all material respects, to generally accepted accounting principles.

### Bonds and mortgages

Bonds and mortgages are carried at amortized cost, net of any allowance for losses. The difference between the proceeds on the sale of a security and its amortized cost is considered to be an adjustment of future portfolio yield and is deferred on the balance sheet and amortized to income over the remaining term to maturity.

The Company ceases to accrue interest on loans that are three months or more in arrears and considers these loans to be impaired as well as any loans that are deemed by management to be non-performing. Events and conditions considered in determining the charge to income during the year relating to the allowance for loan impairment include the value of the security underlying the loan, geographic location, industry classification of the borrower, an assessment of the financial stability of the borrower, repayment history and an assessment of the impact of the current economic conditions. Impaired loans are valued at an amount equal to the estimated net cash flows receivable, discounted at the effective interest rate inherent in the loan at the time of impairment. Any write-down is recognized immediately in income as a charge for loan impairment.

Upon restructuring, impaired loans are recorded at an amount equal to the net cash flows receivable under the modified terms, discounted at the effective interest rate inherent in the loan at the time it was initially recognized as being impaired. Any reduction in the recorded investment is recognized in income as a charge for loan impairment. When collection of the scheduled future cash flows is reasonably assured, interest income is recognized, using the above inherent effective interest rate.

### Equities

Equities are generally carried at moving average market value whereby the carrying value is adjusted towards market value at 15% per annum. Net realized gains and losses on the disposal of equities are deferred and amortized to income at 15% per annum on a declining balance basis. A decline in market value for the portfolio of equities that is considered to be other than temporary is recognized immediately.

Certain universal life insurance products permit a policyholder to choose a stock market based index as an investment option for the accumulated savings component of the policy. To support this liability, the Company has simulated these indices by investing in groups of common stocks, index futures, index participation units and externally managed equity funds. These groups of stocks or futures are accounted for on a market value basis in order to match the market value of the liability.

### Real estate

Real estate held for investment, which includes own-use property, is carried at moving average market value whereby the carrying value is adjusted towards market value at 10% per annum. Net realized gains and losses are deferred and amortized to income at 10% per annum on a declining balance basis. Market values on each property are determined annually and an independent appraisal is obtained every three years. The market value established is an estimate of the realizable value of each property and thus recognizes in that determination an element of depreciation. A decline in market value of the portfolio of real estate that is considered to be other than temporary is recognized immediately.

Real estate acquired on foreclosure and held for sale is carried at the lower of the investment in the loan foreclosed and the estimated net proceeds from sale of the property. Real estate acquired on foreclosure and held for income production is initially recorded at the lower of the investment in the loan foreclosed and the fair value of the assets. Subsequently, foreclosures held for income production are accounted for as investments. For both classifications, write-downs are recognized immediately in income as a charge for loan impairment in the year.

### Policy loans

Policy loans are carried at their unpaid balance and are secured by the cash surrender values of the policies against which the respective loans were made.

### Derivative financial instruments

The Company uses derivative financial instruments to hedge specific transactions; any gains or losses, whether realized or unrealized, are recognized in income on the same basis as the asset or liability that has been hedged.

### Other assets

Other assets include furniture, equipment and leasehold improvements that are carried at cost less accumulated depreciation. Depreciation is provided on a straight-line basis over periods from three to ten years.

### Policy liabilities

Policy liabilities have been calculated using the policy premium method. The process of calculating policy liabilities necessarily involves the use of estimates concerning such factors as mortality and morbidity rates, future investment yields, future investment losses, future expense levels and rates of surrender. Consequently, policy liabilities include appropriate provisions for adverse deviations from those estimates.

### Income taxes

Income taxes are accounted for using the liability method of income tax allocation. Under this method, current income taxes are based on taxable income and future income taxes are based on taxable temporary differences. The income tax rates used to measure income tax assets and liabilities are those rates substantially enacted at the balance sheet date.

### Pension expense and obligation

The Company provides certain pension and other future employment benefits to eligible participants upon retirement. These benefits are provided on both defined benefit and defined contribution bases and reflect compensation history, length of service and level of contributions. The cost of defined benefits is actuarially determined and accrued using the projected benefit method pro-rated on service. This method involves the use of management's best estimates concerning such factors as expected plan investment performance, future salary increases, retirement ages of plan members and expected health care costs. These costs are recognized in the consolidated statement of income in the period during which the services are rendered. Plan assets are carried at market values. The assets supporting the pension benefits are held in separate trusteed pension funds.

The estimated excess of the market value of plan assets over retirement obligations, including adjustments arising from plan amendments and changes in valuation assumptions, is included in income over the estimated average remaining service lives of participants. The excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of the plan assets is amortized over the remaining service period of active participants.

The cumulative difference between the pension expense and the funding contributions for the pension benefits is recorded in the consolidated balance sheet under other assets. The accumulated value of other employee future benefits is recorded in the consolidated balance sheet as other liabilities.

### Segregated fund assets

Certain policy contracts allow the policyholder to invest in segregated investment funds of the Company. The assets of these funds are carried at their year-end market values. The income for these funds includes all realized and unrealized gains and losses, net of related expenses and is included in the value of the fund. Substantially all risks and rewards of ownership accrue to these policyholders; consequently, assets held in segregated fund accounts are not consolidated with the assets of the Company. Cash flows associated with premiums and surrenders of segregated fund policies are initially recorded in the general account and then transferred to or from the segregated account on a net basis so that the segregated accounts business is maintained separately from the general account business.

## 2 Changes in Accounting Policies

### Income taxes

The Company has retroactively, without restatement, adopted Section 3465, Income Taxes, of the Canadian Institute of Chartered Accountants ("CICA") Handbook. This standard requires the use of the liability method of accounting for income taxes and changes the focus from income statement timing differences to balance sheet temporary differences. The impact of this change was an increase to the liability for future income taxes at January 1, 2000 of $2,645 and a decrease in retained earnings at January 1, 2000 of $2,645.

#### EMPLOYEE FUTURE BENEFITS

The Company has prospectively adopted Section 3461, Employee Future Benefits, of the CICA Handbook. This standard requires employee future benefits to be accounted for on an accrual basis and pension obligations to be discounted using a market rate of interest. The impact of this change was not material to these consolidated financial statements.

#### ACCOUNTING FOR COMPUTER SOFTWARE DEVELOPMENT COSTS

In 2000, the Company prospectively changed its policy of accounting for certain software development costs from expensing as incurred to capitalization, to conform more closely to the practices suggested by the American Institute of Certified Public Accountants' Statement of Position 98-1. This statement provides guidance for determining whether computer software is for internal use and when costs incurred for internal use software are to be capitalized. Capitalized software development costs are being depreciated on a straight-line basis over their estimated useful lives, which vary from 4 to 7 years. Adoption of this change of accounting policy resulted in capitalization of $8,588 of software development costs *(see note 6)*.

## 3 ACQUISITION

On October 1, 1999, John Hancock Canadian Holdings Limited ("John Hancock Canada"), the parent of the Company, acquired 100% of the issued and outstanding common shares of Aetna Canada Holdings Limited ("Aetna Canada") for cash consideration of approximately $436 million.

The acquisition was accounted for by the purchase method. Accordingly the purchase price was allocated to the assets and liabilities acquired, based on their estimated fair values at the acquisition date. Upon completion of the acquisition, John Hancock Canada recorded a comprehensive revaluation of the assets and liabilities of the acquired companies by pushing down the fair values and allocating the excess of the purchase price to goodwill in the underlying entities.

On November 4, 1999, the Company acquired all of the issued and outstanding common shares of Aetna Life, a wholly-owned subsidiary of John Hancock Canada in a share-for-share exchange. On November 30, 1999, the Company acquired all of the issued and outstanding common shares of Aetna Acceptance, another wholly-owned subsidiary of John Hancock Canada, in another share-for-share exchange. These acquisitions have been accounted for under the "continuity of interests method". Under the continuity of interests method, the acquisition is reflected as though the Company had always owned the acquirees. Accordingly, the figures for the comparative year includes the results and financial position of Aetna Life and Aetna Acceptance based upon their historical carrying values until the date of acquisition by John Hancock Canada whereupon the estimated fair values were pushed down. The effect of the continuity of interest accounting and the comprehensive revaluation adjustments on the carrying values of the acquired assets and liabilities is as follows:

Aetna Life and Aetna Acceptance Summary Combined Balance Sheets

| | September 30 1999 | Revaluation Adjustments | October 1 1999 | December 31 1998 |
|---|---|---|---|---|
| Invested assets | $ 2,489,599 | $ 244,926 | $ 2,734,525 | $ 2,426,471 |
| Premiums receivable and other assets | 250,742 | (47,672) | 203,070 | 181,582 |
| Goodwill | — | 153,189 | 153,189 | — |
| Total assets | $ 2,740,341 | $ 350,443 | $ 3,090,784 | $ 2,608,053 |
| Policy liabilities | $ 2,252,736 | $ 176,194 | $ 2,428,930 | $ 2,191,744 |
| Other liabilities | 153,242 | (7,008) | 146,234 | 101,885 |
| Subordinated debt | 30,329 | — | 30,329 | 30,329 |
| Deferred gains (losses) | 48,195 | (48,195) | — | 44,097 |
| Participating account | 30,673 | 6,842 | 37,515 | 30,311 |
| Shareholder's equity | 225,166 | 222,610 | 447,776 | 209,687 |
| Total liabilities and shareholder's equity | $ 2,740,341 | $ 350,443 | $ 3,090,784 | $ 2,608,053 |

| Aetna Life and Aetna Acceptance Summary Combined Income Statements | Nine months ended September 30, 1999 |
|---|---|
| Premiums | $ 428,593 |
| Investment income | 153,796 |
| Other | 11,772 |
| Total revenue | 594,161 |
| Policy benefits paid and accrued | 333,162 |
| Decrease in provision for future benefits | 54,628 |
| Selling, general and operating | 192,828 |
| Total expenses | 580,618 |
| Income before income taxes | 13,856 |
| Income taxes | (12,015) |
| Participating policyholder income | (362) |
| Net income to shareholder | $ 1,479 |

A total of $145,321 of the goodwill will be amortized and charged against the non-participating fund income on a straight-line basis over 20 years. However, for the years 2000-2002, the integration is expected to produce maintenance expense savings for the individual life segment that will result in estimated pre-tax policy liability releases of $34,900. The actual amount of such releases will be applied to amortize goodwill in addition to the straight line amortization.

It is expected that the participating fund will contribute to the financing of the purchase in exchange for its share of the value to be derived from the acquisition and integration over the years 2000-2004, guaranteed to be a minimum return of 7.5% on this contribution. Accordingly $4,400 of the purchased goodwill has been allocated to the participating fund and will be amortized as acquisition benefits are realized. Any participating fund goodwill remaining after five years will be charged against the non-participating fund.

In 2000, pre-tax maintenance expense savings of approximately $15,000 were recognized and accordingly, an amount of $8,500, representing the after-tax value of such savings, was recorded as goodwill amortization, in addition to the straight-line amortization charges of $6,100. It is anticipated that approximately $20,000 of additional maintenance expense savings will be recognized in the next two years.

## 4 Invested assets and fair values

Fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties under no compulsion to act. Although quoted market values are a good source of fair value, not all financial instruments have an available trading market. In addition, fair value refers to value at a point in time and is not indicative of future value.

The Company's business involves the exchange of financial instruments. A financial instrument is defined as any contract that gives rise to both a financial asset of one party and a financial liability or equity instrument of another party. A basic function of the business is to match assets with liabilities to be able to meet the long-term obligations to policyholders.

The fair values of the policy liabilities cannot practicably be determined. To the extent that invested assets are accurately matched to policy liabilities, changes in the fair values of the assets due to interest rate changes will have a similar effect on the policy liabilities and will not affect future corporate earnings. The assets supporting the policy liabilities have a fair value of $5,699,157 (1999 - $5,473,757). In addition, deferred net gains of $26,322 (1999 - $33,033) have been taken into account in the determination of policy liabilities. Details of significant terms and conditions, exposures to interest rate and credit risks on policy liabilities are discussed in note 9.

The following indicates the fair value and the carrying value of the Company's assets at December 31. Although real estate is not a financial instrument, it has been included in the table for completeness. For derivatives, see note 7. The fair values shown are not indicative of the overall fair value of the Company.

### Asset valuation

The fair values of short-term investments are estimated to be carrying value due to the nature of these assets. Fair values of bonds and equities are derived from available quoted sources where a ready market exists.

The fair values of mortgages and private placement bonds and equities are calculated by discounting scheduled cash flows through the estimated maturity, using market discount rates. Fair values for real estate are based on the most recent independent appraisal available *(see note 1)*.

| | | 2000 Fair Value | 2000 Carrying Value | 1999 Fair Value | 1999 Carrying Value |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Bonds | - government | $ 1,400,703 | $ 1,329,097 | $ 1,473,651 | $ 1,505,805 |
| | - public | 1,243,316 | 1,226,510 | 1,204,224 | 1,214,606 |
| | - private placements | 894,407 | 832,365 | 752,267 | 721,257 |
| Mortgages | - government insured | 941,844 | 893,594 | 702,879 | 693,930 |
| | - commercial | 792,264 | 778,811 | 791,107 | 753,974 |
| | - residential | 190,109 | 186,237 | 190,536 | 182,345 |
| Equities | - preferred | 269,222 | 268,095 | 165,349 | 172,243 |
| | - common | 178,048 | 175,375 | 160,268 | 159,714 |
| | - private placements | 45,373 | 42,620 | 48,602 | 45,355 |
| | - other | 181,113 | 181,113 | 192,155 | 192,151 |
| Real estate | - foreclosed | 910 | 864 | 17,224 | 13,688 |
| | - investment | 141,392 | 128,830 | 130,366 | 121,609 |
| Short-term investments | | 250,785 | 250,785 | 258,026 | 258,026 |

## Short-term investments

These investments have an aggregate principal amount of $250,785 (1999 - $258,026) with effective interest rates of 4.50% to 6.30% (1999 – 4.84% to 5.60%). Interest is calculated daily and receivable monthly.

## Bonds

Interest is calculated daily and paid semi-annually on government and public bonds. Private placement bonds have interest calculated and paid according to specific contracts. Exposure to credit risk is managed primarily through compliance with quality rating and maximum single issuer guidelines.

| | 2000 Effective Rates | 2000 Carrying Value | 1999 Effective Rates | 1999 Carrying Value |
|---|---|---|---|---|
| Government | 6.01 % | $ 1,329,097 | 6.56 % | $ 1,505,805 |
| Corporate | 7.01 % | $ 2,058,875 | 7.20 % | $ 1,935,863 |

The term to maturity for bond investments, which generally match estimated liability maturities, are as follows:

| Term to maturity | 2000 Fair Value | 2000 Carrying Value | 1999 Fair Value | 1999 Carrying Value |
|---|---|---|---|---|
| Current | $ 163,078 | $ 152,774 | $ 136,532 | $ 135,872 |
| 1-5 years | 711,382 | 692,342 | 759,712 | 756,518 |
| 6-10 years | 577,574 | 564,923 | 630,871 | 631,366 |
| Over 10 years | 2,086,392 | 1,977,933 | 1,903,027 | 1,917,912 |
| | $ 3,538,426 | $ 3,387,972 | $ 3,430,142 | $ 3,441,668 |

## Mortgages

The carrying value of mortgages is amortized cost less allowances for loan impairment. Interest is generally calculated monthly. Credit risk is managed through a program of diversification of type and location of properties, maximum single borrower guidelines and regular borrower and appraisal reviews.

| | 2000 | | | 1999 | | |
|---|---|---|---|---|---|---|
| | Carrying Amount | Effective Interest Rates | Average Maturity (years) | Carrying Amount | Effective Interest Rates | Average Maturity (years) |
| Government insured | $ 893,594 | 7.07 % | 6.35 | $ 693,930 | 7.49 % | 4.18 |
| Commercial | 778,811 | 8.17 % | 6.51 | 753,974 | 8.27 % | 6.07 |
| Residential | 186,237 | 7.64 % | 4.46 | 182,345 | 7.91 % | 5.09 |
| | $ 1,858,642 | | | $ 1,630,249 | | |

Mortgages are secured primarily by first recourse to the underlying property and virtually all are fixed term in duration.

## 5 Impaired investments

Investments classified as non-performing are as follows:

| | 2000 | | | 1999 | | |
|---|---|---|---|---|---|---|
| | Book Value | Allowance for Loan Impairment | Carrying Value | Book Value | Allowance for Loan Impairment | Carrying Value |
| Commercial mortgages | $ 37,786 | $ (3,003) | $ 34,783 | $ 51,491 | $ (11,081) | $ 40,410 |
| Bonds | 19,595 | (7,957) | 11,638 | 11,558 | (6,201) | 5,357 |
| | $ 57,381 | $ (10,960) | $ 46,421 | $ 63,049 | $ (17,282) | $ 45,767 |

In addition, the policy liabilities include provisions for potential future asset default losses *(see note 9)*.

The continuity of the allowance for loan impairment during the year was as follows:

| | 2000 | 1999 |
|---|---|---|
| Balance, beginning of year | $ 17,282 | $ 45,259 |
| Provision for loan impairment | (1,094) | 3,525 |
| Reduction due to dispositions | (830) | (31,516) |
| Net write-offs (recoveries) of loans | (4,398) | 14 |
| Balance, end of year | $ 10,960 | $ 17,282 |

## 6 Other assets

At December 31, other assets consist of:

| | 2000 | 1999 |
|---|---|---|
| Furniture and equipment | $ 95,986 | $ 89,726 |
| Leasehold improvements | 2,842 | 2,697 |
| Internal use software development | 8,588 | — |
| less: accumulated depreciation and amortization | (79,255) | (77,532) |
| | 28,161 | 14,891 |
| Advances to segregated funds | 5,641 | 5,939 |
| Deferred pension costs *(note 22)* | 23,374 | 19,640 |
| Income taxes receivable | 8,511 | 31,756 |
| Administration services receivable | 25,579 | 23,640 |
| Recoverable deficits | 26,831 | 21,794 |
| Due from reinsurers | — | 14,374 |
| Miscellaneous receivables | 75,774 | 43,359 |
| | $ 193,871 | $ 175,393 |

## 7 Derivative financial instruments

The Company uses derivative financial instruments where appropriate in the administration of its asset/liability management strategies and to assist in the management of financial risks, including interest rate and foreign exchange risks. All of the Company's derivative financial instruments are held for hedging purposes, not for speculation.

The notional principal amount of derivative instruments represents an amount to which a rate or price is applied in order to calculate the exchange of cash flows. Notional principal amounts are frequently used as an indicator of business activity, however, they are not indicative of credit or market risk exposure and are not recognized in the financial statements. The following table classifies, by type, the notional principal amounts held at year end:

| | | 2000 | | 1999 |
|---|---|---|---|---|
| | OTC* | Exchange | OTC* | Exchange |
| Interest rate contracts: | | | | |
| Swaps | $ 100,673 | $ — | $ 92,763 | $ — |
| Futures | — | — | — | 11,600 |
| Foreign exchange contracts: | | | | |
| Swaps | 89,622 | — | 97,303 | — |
| Forward rate agreements | — | — | 1,171 | — |
| Equity contracts | 10,000 | 127,716 | 6,750 | 96,397 |
| | $ 200,295 | $ 127,716 | $ 197,987 | $ 107,997 |

* *"Over-the-counter"*

The notional principal amounts by remaining term to maturity are:

| | Remaining term to maturity at December 31, 2000 | | | | 2000 | 1999 |
|---|---|---|---|---|---|---|
| | Within 1 year | 1 to 5 years | 5 to 10 years | Over 10 years | Total notional amount | Total notional amount |
| Interest rate contracts | $ — | $ 58,195 | $ 28,000 | $ 14,478 | $ 100,673 | $ 104,363 |
| Foreign exchange contracts | — | 13,299 | 43,929 | 32,394 | 89,622 | 98,474 |
| Equity contracts | 132,716 | 5,000 | — | — | 137,716 | 103,147 |
| | $ 132,716 | $ 76,494 | $ 71,929 | $ 46,872 | $ 328,011 | $ 305,984 |

### Credit exposure

Credit risk is the exposure to loss in the event of non-performance by the counterparty to the transaction. The Company evaluates and monitors the credit risk of its derivative financial instruments, in much the same way as the credit risks associated with its other financial instruments. All of the counterparties for the Company's OTC derivative activities are financial institutions rated AA(L) or above by independent rating agencies.

The following tables provide a summary of the Company's derivative portfolio and related credit risk exposure.

"Current credit risk" represents the amount of loss that the Company would suffer if every counterparty to which the Company is exposed defaulted immediately (i.e. the current replacement cost of all outstanding derivative contracts with a gain or positive value). These amounts do not take into consideration legal contracts that permit offsetting of positions or the value of any collateral. "Credit equivalent" amount represents the current credit risk exposure plus an estimate of the impact that future changes in interest and foreign currency rates and other indices would have, based upon a formula prescribed by OSFI. "Risk-weighted equivalent" represents the credit risk equivalent weighted according to the creditworthiness of the counterparty, also as prescribed by OSFI.

**2000**

| | Notional amounts | Current credit risk | Credit equivalent amount | Risk weighted equivalent |
|---|---|---|---|---|
| Interest rate contracts | $ 100,673 | $ 1,489 | $ 1,082 | $ 17 |
| Foreign exchange contracts | 89,622 | 620 | 2,646 | 42 |
| Equity contracts | 137,716 | 595 | 1,295 | 21 |
| | $ 328,011 | $ 2,704 | $ 5,023 | $ 80 |

**1999**

| | Notional amounts | Current credit risk | Credit equivalent amount | Risk weighted equivalent |
|---|---|---|---|---|
| Interest rate contracts | $ 104,363 | $ 1,695 | $ 899 | $ 14 |
| Foreign exchange contracts | 98,474 | 1,856 | 5,136 | 82 |
| Equity contracts | 103,147 | 4,935 | 1,956 | 31 |
| | $ 305,984 | $ 8,486 | $ 7,991 | $ 127 |

The next table summarizes the fair value, as represented by the sum of the net unrealized gains and losses, accrued interest receivable and payable and premiums paid or received, of the Company's derivative portfolio at each year end. It segregates derivative instruments between those that are in a favourable or receivable position from those in an unfavourable or payable position. Fair value is verified to external sources and is defined as the net present value of expected future cash flows of all contracts discounted at a market rate commensurate with the risks involved.

| | | | 2000 | | | 1999 |
|---|---|---|---|---|---|---|
| | Favourable | (Unfavourable) | Net fair value | Favourable | (Unfavourable) | Net fair value |
| Interest rate contracts | $ 1,489 | $ (806) | $ 683 | $ 1,695 | $ (2,429) | $ (734) |
| Foreign exchange contracts | 620 | (6,209) | (5,589) | 1,856 | (2,376) | (520) |
| Equity contracts | 595 | (5,487) | (4,892) | 4,935 | — | 4,935 |
| | $ 2,704 | $ (12,502) | $ (9,798) | $ 8,486 | $ (4,805) | $ 3,681 |

## 8 Mortgage securitization

The Company has sold for cash, without recourse, undivided interests in pools of mortgages insured under the National Housing Act by the Government of Canada. Gains or losses on the sale of the mortgages are amortized to income over the life of the underlying mortgage pools and are recognized within net investment income.

The Company retains the servicing right for these pools of mortgages that had outstanding principal balances of $145,360 (1999 - $174,405) at December 31. Servicing fee income, net of expenses, is recognized as earned and recorded within net investment income.

## 9 Policy liabilities

### A. Nature and composition

Policy liabilities represent the amounts that, together with estimated future premiums and investment income, will be sufficient to pay estimated future benefits, policy dividends and expenses on policies in force at the valuation date. Policy liabilities are determined using accepted actuarial practice, according to standards established by the Canadian Institute of Actuaries ("CIA").

The Company is active in three major lines of business: individual life insurance including living benefits, investment products and group life and health. The composition of the policy liabilities, net of reinsurance *(see note 10)* and the assets backing them are as follows:

| 2000 | Individual Life | Investment Products | Living Benefits | Group Life & Health | 2000 Total |
|---|---|---|---|---|---|
| Participating policies | $ 638,969 | $ 1,698 | $ — | $ — | $ 640,667 |
| Non-participating policies | 1,905,695 | 1,473,005 | 115,999 | 1,363,933 | 4,858,632 |
| Total policy liabilities | $ 2,544,664 | $ 1,474,703 | $ 115,999 | $ 1,363,933 | $ 5,499,299 |
| *Assets backing liabilities:* | | | | | |
| Bonds | $ 1,416,383 | $ 843,573 | $ 106,994 | $ 680,009 | $ 3,046,959 |
| Mortgages | 558,444 | 674,237 | 7,771 | 591,600 | 1,832,052 |
| Equities | 339,258 | 336 | — | — | 339,594 |
| Other | 230,579 | (43,443) | 1,234 | 92,324 | 280,694 |
| | $ 2,544,664 | $ 1,474,703 | $ 115,999 | $ 1,363,933 | $ 5,499,299 |

| 1999 | Individual Life | Investment Products | Living Benefits | Group Life & Health | 1999 Total |
|---|---|---|---|---|---|
| Participating policies | $ 625,696 | $ 1,618 | $ — | $ — | $ 627,314 |
| Non-participating policies | 1,753,166 | 1,682,349 | 113,816 | 1,244,221 | 4,793,551 |
| Total policy liabilities | $ 2,378,861 | $ 1,683,967 | $ 113,816 | $ 1,244,221 | $ 5,420,865 |
| *Assets backing liabilities:* | | | | | |
| Bonds | $ 1,274,534 | $ 1,049,463 | $ 107,170 | $ 656,694 | $ 3,087,861 |
| Mortgages | 497,922 | 672,505 | 724 | 413,948 | 1,585,099 |
| Equities | 355,679 | 47 | — | — | 355,726 |
| Other | 250,726 | (38,048) | 5,922 | 173,579 | 392,179 |
| | $ 2,378,861 | $ 1,683,967 | $ 113,816 | $ 1,244,221 | $ 5,420,865 |

### B. Assumptions

The Company provides financial security products and must measure and manage risk. This is reflected in the valuation of policy liabilities. In light of the long-term risks and measurement uncertainties inherent in the life insurance business, policy liabilities are established using "best estimate" assumptions plus a margin for adverse deviation, separately for each variable. If emerging experience is less favourable than assumed in the valuation, profits would diminish and losses could result.

"Best estimate" assumptions cover mortality, morbidity, investment returns, rates of policy terminations (lapses), levels of operating expenses, and policyholder dividends. The methods for arriving at the most important of these assumptions are outlined below.

#### Mortality

For individual life insurance, the Company monitors its mortality on a regular basis and compares the results to the Canadian industry study conducted annually by the CIA. The valuation mortality assumption has been derived from a combination of the Company's experience and industry experience.

For annuities, the mortality rates in the industry tables are projected forward to the year of each future annuity payment to allow for continuing mortality improvement. This is an appropriately conservative adjustment to make in valuing annuities – it extends the assumed payment period which produces a larger policy liability.

#### Morbidity

The Company underwrites disability income, disability waiver of premium and other living benefits. The Company's exposures to morbidity risk arise from the possibilities that the incidence of claims is greater or earlier than expected and, where relevant, claim terminations from death or recovery occur less frequently than expected.

The Company uses a combination of industry tables and its own recent experience in setting its best estimate claims incidence and termination.

#### Investment returns

The Company maintains notional asset portfolios matching specific segments of policy liabilities. This allows management to monitor and assess the success of the various investment strategies being employed. All assets in the Company's general fund are available to pay all liabilities of the general fund, with first preference to policy liabilities.

The Company has an Investment Policy Statement ("IPS") which, coupled with the Investment Operating Guidelines ("IOG"), articulate prudent person practices for its lending and portfolio management – practices a prudent person would apply to avoid undue risk of loss and obtain a reasonable rate of return. The IPS is approved by the Board of Directors and is subject to annual review. The IOG are approved by the Investment Committee of the Board. These documents outline governance with respect to exposure limits, credit quality, interest rate risk and liquidity. The valuation of policy liabilities makes explicit provision for credit risk and interest rate risk.

*i Credit risk*

The Company has made provision in its financial statements for credit losses expected for assets it currently holds. Provisions have been made partly through reduction in the value of specific assets judged to be impaired and partly through a provision in the policy liabilities. The best estimate assumptions take into account current quality ratings for all investments, credit analysis, quality deterioration (ratings drift) and economic indicators that are considered linked to credit risk that may be cyclical.

The Company reviews its own experience and published credit loss studies to develop and maintain best estimate long term credit loss allowances for each distinct asset credit class. The policy liabilities produced using the average of these allowances may be supplemented if credit analysis, economic trends or business plan forecasts indicate that credit losses are likely to be higher, in the near term, than the average of the long term allowances.

Credit losses were lower than assumed in 1999 and 2000 but had been less favourable than assumed in the previous years, most of such prior losses being attributable to the Company's mortgages on office and industrial properties in a few key urban areas.

The policy liabilities would increase by 1.05% (1999 – 0.95%) if the long-term credit loss assumption was increased to 150% of the assumption used.

*ii Interest rate risk*

The Company's financial position may be affected by its exposure to interest rate risk. Interest rate risk is the risk of economic losses or gains arising from the reinvestment or disinvestment of cash flows. If the assets supporting the policy liabilities do not match the timing and amount of the policy obligations, interest rate losses or gains may occur due to changing interest rates in the future. The Company has an asset/liability management program that achieves an effective match.

For the group and investment products segments, asset and liability cash flows are closely matched by term and duration so the reinvestment assumption is relatively unimportant. The objective is to maintain asset durations within 10% of liability durations for each of these portfolios. The cash flows are subjected to tests under a wide range of possible economic scenarios (as represented by the yield curve and changes to it) and the policy liabilities are then increased directly where necessary to provide for future uncertainty. This testing indicates that these segments are adversely exposed to increases in interest rates because the assets are slightly longer than the liabilities. For these policy liabilities, the difference between the scenario assuming a 1% increase in interest rates at all points along the yield curve and the scenario assuming the current yield curve forever is $7,100 (1999 - $1,700) or 0.25% (1999 - 0.06%) of the policy liabilities reported.

The majority of adjustable insurance is universal life. The investment accounts of these policies are closely matched. At present, more than half of these accounts are invested in equity-related options which the Company matches within narrow tracking tolerances using various equity instruments – actual common stocks, equity futures or exchange-traded unit trusts.

For guaranteed non-participating insurance, benefit payments are typically later than asset cash flows which means that reinvestment assumptions are important to the valuation of this class of business. Projected policy cash flows and invested assets' cash flows are combined with future reinvestment rates and the Company's investment policy to determine assumed rates of return for all future years. The reinvestment rate assumed for 2001 is 6.50% which was derived by adding an expected credit spread to the current yield of long term Government of Canada bonds. Reinvestment rates are assumed to gradually decrease each year after 2001 until they reach an ultimate level below 5.0%.

*iii Product performance guarantees*

The Company guarantees minimum rates of return with respect to the savings elements of Adjustable and Universal Life insurance policies. These guarantees create a cost to the Company (are "in the money") whenever its investment strategy produces a return which is less than the sum of the guaranteed minimum returns payable to customers and its investment spread related costs. Some of the Company's outstanding guarantees were "in the money" at December 31, 2000. Guarantees for recent and future new issues have been revised so that the Company's future exposure will largely be limited to an existing closed block of inforce policies. The valuation of policy liabilities assumes "in the money" situations persist and incorporates a margin for future deterioration.

For segregated funds, the Company guarantees minimum proceeds on the maturity date of the policy or on the earlier death of the annuitant. These guarantees exceed those that the Company must provide as defined by regulation. The

Company regularly monitors its exposure to these guarantees and measures their costs under a wide range of persistency and future fund performance scenarios (both randomly generated and predefined). The key risk to which the Company is exposed is very poor fund(s) performance combined with uncharacteristically good persistency. The product design and marketing focus have produced a widely dispersed maturity date profile for the inforce business that provides important diversification and risk mitigation. The policy liabilities include an amount for these guarantees. The method of determining this amount conforms with the approach described by the CIA in its 2000 Guidance Note.

#### Lapses

Lapse and surrender assumptions are important in valuing individual life insurance because the surrender value of a policy (Cash Surrender Value) can often be quite different than the value of future benefits to be derived by continuing the policy in force. This is most evident with a pure "Term to 100" policy which has no cash surrender value but has inherent increasing value as the policy ages because the premium is fixed based on the issue age. Such a policy is often referred to as lapse-supported.

The Company derives lapse and surrender assumptions mainly from internal studies, in combination with meaningful inter-company studies where available, adjusted for consistency with the future expected economic and mortality environment described above. Separate lapse assumptions are used for permanent cash value business, for renewable term insurance and for lapse-supported business. CIA guidelines prescribe the maximum rate that can be assumed for lapse-supported policies to limit future lapse gains that are counted in the valuation. In setting lapse rates for renewable term insurance, it is assumed that extra lapses will occur at each renewal point because of the requirement to pay an increased premium. It is further assumed that healthy life insureds are more likely to lapse at that time than those whose health has deteriorated since issue, especially those that are now uninsurable.

The Company has a portfolio of lapse-supported life policies which account for $1,424 million (1999 - $1,274 million) of policy liabilities. As an indication of the sensitivity of these policy liabilities to the future assumed lapse rates, the lapse component of the Minimum Continuing Capital and Surplus Requirement attributable to these policies is $22 million (1999 - $23 million). This component is determined by recalculating the policy liabilities using more conservative lapse rates, with the change in lapse rates being twice as great for fully guaranteed policies than for adjustable ones.

#### Policy expenses

The policy liabilities provide for future maintenance expenses, claims adjudication expenses, premium tax, investment income tax, other taxes not integrated with income taxes, reinsurance costs, and renewal commissions to agents.

Policy maintenance expenses are derived from the Company's internal cost allocation studies with no material allowance for anticipated future productivity gains. Future unit cost rates are assumed to increase at an inflation rate which is consistent with the future economic scenarios described above i.e. it is linked to the assumed yield curve on the basis that the real return is relatively fixed over time. The valuation of the policy liabilities reflects expense savings as realized.

#### Policyholder dividends

Policy liabilities for participating insurance include the present value of future policyholder dividends. Dividend scales are consistent with the Company's dividend policy, and are assumed to adjust in a manner consistent with future experience assumed.

### Margins for adverse deviations

The basic assumptions made in establishing policy liabilities are best estimates for a range of possible outcomes. Companies are required to include a margin in each assumption which increases the policy liability otherwise produced to recognize the uncertainty in establishing these best estimates and to allow for the possible deterioration in experience. A range of allowable margins is prescribed by the CIA. The choice of the margin from this range – low, medium or high – is based on consideration of a number of factors specific to the assumption including: credibility of experience studies, sophistication of the Company's measurement and reaction processes, degree of risk-sharing with the policyholder (i.e. adjustment provisions) and the term of the contract, to name a few. The Company generally maintains margins near the middle of the allowable ranges except where the risk is significantly shared with the policyholder, in which case a lower margin is used.

### C. Changes in provision for future policy benefits

Changes in the provision for future policy benefits during the year were caused by the following business activities and changes in actuarial assumptions:

| | 2000 | 1999 |
|---|---|---|
| Balance, beginning of year | $ 4,861,148 | $ 4,595,856 |
| Normal changes due to | | |
| - new policies | 257 | 9,404 |
| - inforce policies | 99,349 | 90,182 |
| Acquisition of Aetna Life *(note 3)* | — | 176,194 |
| Acquisition of individual life block | — | 11,461 |
| Expense and tax synergies from Aetna Canada aquisition | (63,930) | — |
| Reclassifications among policy liability categories | 6,171 | (22,366) |
| Reinsurance recapture | — | 13,417 |
| Changes in actuarial assumptions and refinements of estimates | | |
| - non-participating | 9,750 | (5,300) |
| - participating | (2,100) | (7,700) |
| Balance, end of year | $ 4,910,645 | $ 4,861,148 |

Valuation assumptions are reviewed and updated annually based on emerging experience. The impact of the major assumption changes and refinement of estimates is as follows:

| | 2000 | 1999 |
|---|---|---|
| Assumed future interest rates | $ 320 | $ 2,800 |
| Morbidity | (8,150) | (4,000) |
| Mortality | 1,380 | (33,700) |
| Lapse | 17,500 | 5,300 |
| Maintenance expenses | 2,490 | 3,700 |
| All other | (5,890) | 12,900 |
| | $ 7,650 | $ (13,000) |

## 10 Reinsurance

The Company reinsures excess mortality, morbidity and lapse exposures on a life insured to limit its loss. It also has catastrophe reinsurance in place to limit the loss it incurs from multiple claims resulting from the same event. The Company's maximum retentions, established separately for individual life, living benefits, group life and group health, are subject to Board approval. Materially all of the reinsurance is ceded to federally registered reinsurance companies operating in Canada.

Reinsurance ceded does not discharge the Company's liability as the primary insurer. Failure of reinsurers to honour their obligations could result in losses to the Company. A contingent liability exists should an assuming company be unable to meet its obligations. The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk with its reinsurers to minimize its exposure to losses from reinsurer insolvency.

The amounts shown in the financial statements are net of the following amounts relating to reinsurance ceded:

| | 2000 | 1999 |
|---|---|---|
| Provision for future policy benefits | $ 1,791,061 | $ 1,460,566 |
| Premiums | 353,916 | 286,476 |
| Policy benefits | 207,525 | 181,208 |
| Commissions and operating expenses | 31,264 | 38,465 |

## 11 Notes payable to reinsurers

The Company has issued notes payable to reinsurers that bear interest at a rate equal to the rate of return on a specified portfolio of assets. At December 31, 2000, the outstanding balance owing under these notes was $92,789 (1999 - $100,794).

## 12 Deferred net gains

Deferred net gains (losses) on disposal of invested assets is comprised of the following:

| | 2000 | 1999 |
|---|---|---|
| Bonds | $ 24,071 | $ 30,582 |
| Mortgages | 2,295 | 2,398 |
| Equities | 14,304 | 3,927 |
| Real estate | (1,442) | (1,627) |
| | $ 39,228 | $ 35,280 |

## 13 Other liabilities

At December 31, other liabilities consist of:

| | 2000 | 1999 |
|---|---|---|
| Accounts payable and accrued liabilities | $ 54,846 | $ 49,279 |
| Outstanding cheques | 27,736 | 17,073 |
| Administration services payables | 36,117 | 33,787 |
| Pending transfer to segregated funds | 15,046 | — |
| Post-retirement benefits *(note 22)* | 9,647 | 9,362 |
| Due to reinsurers | 19,173 | 18,340 |
| Mortgages payable | 9,838 | 10,974 |
| Notes payable | 24,689 | 25,186 |
| Taxes, licenses, fees payable | 15,641 | 12,548 |
| Accrued interest on subordinated debt | 9,318 | 2,954 |
| Miscellaneous | 31,991 | 19,899 |
| | $ 254,042 | $ 199,402 |

The amounts included in mortgages payable represent charges on real estate that are repayable in varying terms to the year 2002 and bear interest at rates ranging from 7.25% to 8.75% per annum. The payments required to meet mortgage obligations are as follows: 2001 - $9,511; 2002 - $684. Interest expense for the year ended December 31, 2000 was $770 (1999 - $853). The fair value of the mortgages payable was calculated by discounting scheduled repayments at current market rates and was estimated to be $9,992 (1999 - $11,149).

The notes payable from the acquisition of certain properties are payable over a period of eight years that commenced in 1999. The carrying value of the notes represents the present value for the repayment schedule discounted at 9.5%. The Company holds Government of Canada bonds purchased to match the maturity of the notes payable which are included in the bonds shown in note 4.

## 14 Subordinated debt

The Company has financed some of its operations through the issue of subordinated debt. The debt is subordinated in right of payment to all policy liabilities of the Company and all other liabilities except those that, by their terms, rank equally with or subordinate to this debt and consists of the following:

| Payable to | Maturity | Interest rate | 2000 | 1999 |
|---|---|---|---|---|
| John Hancock Canada | October 15, 2007 | 7.50 % | $ 70,000 | $ 70,000 |
| John Hancock Canada | July 30, 2014 | 6.81 % | 20,000 | 20,000 |
| John Hancock Canada | October 1, 2014 | 7.19 % | 86,000 | 86,000 |
| | | | $ 176,000 | $ 176,000 |

The interest is payable semi-annually and total interest expense of $12,778 (1999 - $8,908) related to this debt is included in the statements of income. The fair value of the subordinated debt was calculated by discounting scheduled repayments at current market rates and was estimated to be $178,754 (1999 - $168,302).

## 15 Distribution of income

Distributions of income to shareholders and to participating policyholders are established by resolutions of the Board of Directors. From time to time, the Board of Directors sets apart a portion of the income of the participating account as safe and proper for distribution as dividends or bonuses. Of the amount set apart, the shareholders are entitled to a portion as specified in the governing statute. The amount eligible for future transfer to shareholders can be transferred only when further dividends are paid to participating policyholders.

The cumulative amount eligible for future transfer of $4,942 at December 31, 2000 (1999 - $4,563) is included in the participating account.

The Company has made a commitment to declare dividends in respect of the participating policies for a five year period at a scale not less than the scale in effect in respect of those policies' anniversaries in 1999, provided that the relevant demographic and economic conditions remain the same as in 1999. Commitments made in respect of dividends for a previously acquired block of participating policies will be honoured by the Company.

As at December 31, the cumulative amount of $49,934 (1999 - $45,427) of the participating account has been allocated to participating policyholders but has not yet been distributed by way of declared dividends.

## 16 Share capital

| | | | 2000 | 1999 |
|---|---|---|---|---|
| Authorized: | 3,960,000 | first preferred shares issuable in series | | |
| | 4,000,000 | second preferred shares, Series 1 | | |
| | 4,000,000 | second preferred shares, Series 2 | | |
| | 5,000,000 | common shares | | |
| Issued: | 1,400,000 | first preferred shares, series A non-voting, cumulative, and redeemable at the Company's option at their par value of $25.00 | $ 35,000 | $ 35,000 |
| | 4,000,000 | second preferred shares, Series 1 | 97,106 | 97,106 |
| | 350,175 | common shares | 53,745 | 53,745 |
| | | | $ 185,851 | $ 185,851 |

On October 1, 1999 the Company increased its authorized number of common shares from 200,000 to 5,000,000 and, on November 4, 1999, issued a further 160,880 common shares to John Hancock Canada in exchange for 100% of the common shares of Aetna Life. On November 30, 1999 the Company issued a further one common share to John Hancock Canada in exchange for 100% of the common shares of Aetna Acceptance.

On October 25, 1999 the Company authorized the issue of 8,000,000 Second Preferred Shares, of which 4,000,000 have been designated as Series 1 and 4,000,000 as Series 2. The Second Preferred Shares are non-voting and ranking on a parity with the First Preferred Shares and in preference to the common shares.

The Series 1 Second Preferred Shares bear non-cumulative dividends at a fixed rate of 6.1%, payable quarterly until December 31, 2004 whereupon the dividend rate will be the greater of: (i) one-quarter of 90% of the average daily prime rate charged by two Schedule 1 Canadian chartered banks for that quarter, and (ii) 5.85% per annum, prorated for the quarter. The Series 1 Second Preferred Shares are redeemable at the Company's option on December 31, 2004 and every five years plus one day thereafter at a price of $25.00 per share or at any other time after December 31, 2004 at $25.50 per share. Also on December 31, 2004 and every five years plus one day thereafter the Series 1 Second Preferred Shares are convertible at the holder's option into an equal number of Series 2 Second Preferred Shares, subject to a minimum number of shares remaining in the series.

The Series 2 Second Preferred Shares generally have the same provisions as the Series 1 Second Preferred Shares with the following exceptions. They bear fixed non-cumulative dividends at a rate equal to a selected percentage of the Government of Canada 5 year bond yield, as determined by the Board of Directors, payable quarterly. They are redeemable at the Company's option on January 1, 2010 and on each successive five years plus one day anniversary thereafter. They are convertible by the holder on January 1, 2010 and on each five

years plus one day thereafter into an equal number of Series 1 Second Preferred Shares, subject to a minimum number of shares remaining in the series.

On November 19, 1999 the Company issued 4,000,000 Series 1 Second Preferred shares for cash of $100,000. Share issue costs were $2,894.

## 17 Investment income

Investment income was derived from the following sources:

| | 2000 | 1999 |
|---|---|---|
| Bonds and debentures | $ 229,405 | $ 235,420 |
| Mortgages | 126,169 | 136,002 |
| Equities | 37,809 | 64,117 |
| Real estate | 27,479 | 29,113 |
| Policy loans | 7,493 | 6,919 |
| Short-term investments | 17,684 | 12,090 |
| Other investment income | (19,484) | 2,413 |
| Amortization of deferred gains and losses | | |
| Bonds | 4,513 | 7,483 |
| Mortgages | 5,465 | 6,165 |
| Equities | 1,473 | 29,932 |
| Real estate | 856 | (93) |
| Investment expenses | (17,336) | (18,892) |
| | $ 421,526 | $ 510,669 |

## 18 Unusual items

Unusual items included in the income statement consist of:

| | 2000 | 1999 |
|---|---|---|
| Gain on pension conversion *(note 22)* | $ (3,369) | $ (5,609) |
| Integration costs | 14,912 | 4,702 |
| Costs associated with the sale of Aetna Canada | – | 36,252 |
| Restructuring costs of Aetna Health | – | 3,303 |
| | $ 11,543 | $ 38,648 |

## 19 Income taxes

The income tax expense for the year consists of:

| | 2000 | 1999 |
|---|---|---|
| Current | $ 11,120 | $ 7,196 |
| Future | 47,332 | — |
| Deferred | — | 28,884 |
| | $ 58,452 | $ 36,080 |

The major components of the income tax expense include:

| | | 2000 | 1999 |
|---|---|---|---|
| *Current:* | Federal income taxes | $ 2,022 | $ 1,609 |
| | Federal capital taxes | 3,232 | 2,563 |
| | Provincial income taxes | 5,866 | 3,024 |
| | | 11,120 | 7,196 |
| *Future:* | Federal income taxes | 52,325 | 30,025 |
| | Provincial income taxes | (4,993) | (1,141) |
| | | 47,332 | 28,884 |
| | | $ 58,452 | $ 36,080 |

The provision for income taxes varies from the expected provision at statutory rates for the following reasons:

| | 2000 | 1999 |
|---|---|---|
| Provision for income taxes at statutory rate | 43.0 % | 43.6 % |
| Increase (decrease) from statutory rate: | | |
| Tax reduction on Canadian dividends | (5.4) | (12.1) |
| Large corporations tax | 2.0 | 3.1 |
| Effect of change in future statutory rates | (5.0) | — |
| Prior years reassessments and adjustments | (0.1) | 7.1 |
| Other | 1.2 | 2.0 |
| Effective tax rate | 35.7 % | 43.7 % |

The significant components of the Company's future (deferred for 1999) tax assets and liabilities were as follows:

| | 2000 | 1999 |
|---|---|---|
| *Future tax assets:* | | |
| Policy liabilities | $ 89,664 | $ 168,724 |
| Other | 7,030 | 6,778 |
| | 96,694 | 175,502 |
| *Future tax liabilities:* | | |
| Invested assets | (160,661) | (195,274) |
| Other assets | (3,795) | (1,936) |
| Pension benefits | (8,456) | (4,788) |
| Other | (6,242) | (6,172) |
| | (179,154) | (208,170) |
| | $ (82,460) | $ (32,668) |

## 20 Net income to shareholders

Net income to shareholders has been derived from the following sources:

| | 2000 | 1999 |
|---|---|---|
| Participating business | $ 1,609 | $ 1,965 |
| Non-participating business | 84,259 | 34,265 |
| | $ 85,868 | $ 36,230 |

## 21 Earnings per common share

Earnings per common share ("EPS") is calculated after adjusting net income for the amount of income attributable to preferred shareholders as follows:

| | 2000 | 1999 |
|---|---|---|
| Net income to shareholders | $ 85,868 | $ 36,230 |
| Deduct: | | |
| Preferred shareholder dividends | 7,920 | 2,316 |
| Net income attributable to common shareholders | 77,948 | 33,914 |
| EPS attributable to common shareholders *(in dollars)* | $ 222.60 | $ 96.85 |

## 22 Future employee benefits

The Company provides pension benefits to substantially all employees. These benefits are provided through two defined benefit pension plans and two defined contribution pension plans. Pension benefits provided under the defined benefit pension plans are based on years of service and average compensation generally during the five years prior to retirement.

On January 1, 1999 the Company established a defined contribution plan for all new staff and offered a conversion privilege for existing staff in one of its defined benefit plans effective April 4, 1999. Upon conversion, $19,175 of assets and $19,175 of related obligations were transferred from that defined benefit plan to the defined contribution plan. The Company accounted for the pension plan conversion as a pension plan curtailment and accordingly a gain of $5,609 has been included in unusual items in the income statement in 1999.

In December 1999 the Company offered a conversion privilege for existing staff in its other defined benefit plan effective July 9, 2000. Upon conversion, $23,114 of assets and $23,114 of related obligations will be transferred from that defined benefit plan to the defined contribution plan. The Company accounted for the pension plan conversion as a pension plan curtailment and accordingly a gain of $3,369 has been included in unusual items in the income statement in 2000.

The Company also provides medical, dental and life insurance benefits under a closed post-retirement benefit plan. The Company has accrued for the estimated present value of this obligation, which will be paid to beneficiaries as costs are incurred by them.

The total expense for the Company's defined contribution plans is $2,732 (1999 - $1,520).

The changes in benefit obligation and plan assets related to the Company's defined benefit plans are summarized as follows:

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | 2000 | 1999 | 2000 | 1999 |
| Change in benefit obligation: | | | | |
| Balance, beginning of year | $ 90,033 | $ 100,250 | $ 9,362 | $ — |
| Current service cost | 4,091 | 4,507 | — | — |
| Interest cost | 7,183 | 6,681 | 655 | 612 |
| Benefits paid | (4,005) | (5,514) | (370) | — |
| Actuarial gains | 11,725 | 1,029 | — | — |
| Plan amendments | — | 2,706 | — | 8,750 |
| Settlements | — | (19,175) | — | — |
| Curtailments | — | (451) | — | — |
| Balance, end of year | $ 109,027 | $ 90,033 | $ 9,647 | $ 9,362 |

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | 2000 | 1999 | 2000 | 1999 |
| Plan assets: | | | | |
| Fair value, beginning of year | $ 132,189 | $ 148,639 | $ — | $ — |
| Actual return on plan assets | 10,979 | 7,540 | — | — |
| Employer contributions | 554 | 699 | — | — |
| Benefits paid | (4,005) | (5,514) | — | — |
| Curtailments/settlements | 2,552 | (19,175) | — | — |
| Fair value, end of year | 142,269 | 132,189 | — | — |
| Funded status – plan surplus (deficit) | 33,242 | 42,156 | (9,647) | (9,362) |
| Unamortized net transitional asset | (9,868) | (22,516) | — | — |
| Accrued benefit asset (liability) | $ 23,374 | $ 19,640 | $ (9,647) | $ (9,362) |

The assumptions used in accounting for the Company's benefit obligations are as follows:

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | 2000 | 1999 | 2000 | 1999 |
| Discount rate | 7.0 % | 6.5 - 8.5 % | 7.0 % | — |
| Expected return on plan assets | 7.5 % | 6.5 - 8.5 % | 7.5 % | — |
| Rate of compensation increase | 4.5 % | 4.5 - 5.0 % | 4.5 % | — |

For measurement purposes, a 10% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2000. The rate was assumed to decrease by 1% per annum to 6% in 2004 and remain at that level thereafter. Dental costs were assumed to increase at a constant 6% per year. Increasing these assumptions by 1% per year would increase post-retirement benefits expense for the year by $402 while decreasing these assumptions would decrease post-retirement benefits expense for the year by $218.

## 23 Contingent liabilities

From time to time in connection with its operations, the Company is named as a defendant in actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the outcome of the various proceedings at this time, such actions have generally been resolved with minimal expenses in excess of amounts provided for in policy liabilities and the Company does not believe that it will incur any significant additional loss or expense in connection with such actions.

## 24 Commitments

Future minimum payments under non-cancellable operating leases for premises and equipment having terms in excess of one year consist of: 2001 - $8,220; 2002 - $7,187; 2003 - $5,635; 2004 - $4,747; 2005 - $4,409 and thereafter - $30,569.

## 25 Related party transactions

The Company had entered into reinsurance agreements with an enterprise that was under common control until October 1, 1999. Premiums and payments to policyholders and beneficiaries ceded while the enterprise was under common control for the year ended December 31, 1999 amounted to $12,790 and $7,308 respectively.

These transactions were conducted in the normal course of operations and are measured at the consideration established and agreed to by the related parties. *See also note 14.*

## 26 Segmented information

The Company operates in the Canadian life insurance industry and conducts its operations in two business line divisions that cover four operating segments: Life Insurance, Investment Products, Living Benefits, and Group Life & Health. Life insurance covers individuals and includes traditional whole and term life products, disability, critical illness insurance as well as universal life. Investment Products include individual and group immediate and deferred annuities, guaranteed savings, group pensions and segregated fund investments. Living Benefits includes individual disability and critical illness insurance. Group Life & Health includes group life and accident & sickness insurance.

The Life, Investment Products and Living Benefits segments are managed under the Retail Division because they share the same distribution channels and have common marketing strategies. The Group Division is managed separately.

The Company's support systems are comprised of two divisions. First, the Investments Division has responsibility for ensuring the assets supporting the policy liabilities are appropriately invested. Secondly, the Corporate Division is responsible for the staff, facility and technology infrastructures, capital, asset/liability matching and liquidity management, compliance and corporate governance. The costs for the support divisions are allocated to the business segments.

The following chart shows summarized operating income by segment. For policy liabilities and supporting assets, also see note 9. Unusual items, interest on subordinated debt and income taxes are not allocated to operating segments.

| | Life Insurance | Investment Products | Living Benefits | Group Life & Health | Total |
|---|---|---|---|---|---|
| **2000** | | | | | |
| Revenue | | | | | |
| Premiums | $ 411,032 | $ 29,032 | $ 29,208 | $ 774,735 | $ 1,244,007 |
| Investment income | 164,822 | 144,263 | 8,404 | 104,037 | 421,526 |
| Other | 954 | 93,008 | 51 | 35,394 | 129,407 |
| | 576,808 | 266,303 | 37,663 | 914,166 | 1,794,940 |
| Policy benefits and expenses | | | | | |
| Policy benefits paid and accrued | 283,360 | 16,851 | 9,044 | 746,082 | 1,055,337 |
| Commissions, selling and operating expenses | 162,554 | 105,993 | 15,082 | 152,175 | 435,804 |
| Transfer to segregated funds | (588) | 107,519 | — | — | 106,931 |
| Interest on notes payable | 8,741 | — | — | — | 8,741 |
| | 454,067 | 230,363 | 24,126 | 898,257 | 1,606,813 |
| Operating income before unusual items, interest on subordinated debt and income taxes | $ 122,741 | $ 35,940 | $ 13,537 | $ 15,909 | $ 188,127 |

| | Life Insurance | Investment Products | Living Benefits | Group Life & Health | Total |
|---|---|---|---|---|---|
| **1999** | | | | | |
| Revenue | | | | | |
| Premiums | $ 406,272 | $ 57,553 | $ 29,827 | $ 711,760 | $ 1,205,412 |
| Investment income | 247,638 | 163,823 | 8,175 | 91,033 | 510,669 |
| Other | 12,685 | 70,505 | 18 | 29,492 | 112,700 |
| | 666,595 | 291,881 | 38,020 | 832,285 | 1,828,781 |
| Policy benefits and expenses | | | | | |
| Policy benefits paid and accrued | 390,200 | 72,117 | 12,015 | 677,107 | 1,151,439 |
| Commissions, selling and operating expenses | 175,717 | 87,994 | 13,839 | 161,714 | 439,264 |
| Transfer to segregated funds | (713) | 98,231 | — | — | 97,518 |
| Interest on notes payable | 8,883 | — | — | — | 8,883 |
| | 574,087 | 258,342 | 25,854 | 838,821 | 1,697,104 |
| Operating income before unusual items, interest on subordinated debt and income taxes | $ 92,508 | $ 33,539 | $ 12,166 | $ (6,536) | $ 131,677 |

## 27 Supplemental cash flow information

*Cash flows from investing activities*

Cash flows from investing activities include the following summary transactions involving invested assets:

| | 2000 | 1999 |
|---|---|---|
| Sales, maturities, prepayments and scheduled redemption of: | | |
| Bonds | $ 1,187,051 | $ 582,084 |
| Equities | 183,175 | 99,327 |
| Real estate | 7,576 | 15,233 |
| Mortgages | 225,612 | 323,509 |
| Other | 23,016 | 78,977 |
| | $ 1,626,430 | $ 1,099,130 |

| | 2000 | 1999 |
|---|---|---|
| Purchase / issue of: | | |
| Bonds | $ (1,101,933) | $ (839,981) |
| Equities | (279,659) | (153,607) |
| Real estate | (604) | (1,046) |
| Mortgages | (454,017) | (102,031) |
| Other | (26,141) | (26,053) |
| | $ (1,862,354) | $ (1,122,718) |

*Cash and cash equivalents definition*

| | 2000 | 1999 |
|---|---|---|
| Outstanding cheques | $ (27,736) | $ (17,073) |
| Term deposits with original maturities of 90 days or less, at interest rates of 5.44% to 5.89% (1999 – 4.97% to 5.61%) | 208,257 | 226,448 |
| | $ 180,521 | $ 209,375 |

*Other supplementary cash information*

| | 2000 | 1999 |
|---|---|---|
| Cash paid for: | | |
| Interest | $ 25,280 | $ 21,585 |
| Dividends on redeemable preferred shares | 7,920 | 2,316 |
| Income taxes | 7,862 | 31,997 |
| | $ 41,062 | $ 55,898 |
| Cash dividends and interest received | $ 396,087 | $ 372,917 |

## 28 Comparative figures

Certain of the comparative figures have been reclassified to conform to the presentation adopted in the current year.

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# Maritime Life Offices

## Head Office

2701 Dutch Village Rd.
Halifax, Nova Scotia B3J 2X5
(902) 453-4300

## Atlantic Canada

*Retail Marketing and Service*
*Pension Sales and Marketing*

2695 Dutch Village Rd.
Suite 600
Halifax, Nova Scotia B3L 4T9
(902) 453-4300

*Group Operations*

2745 Dutch Village Rd.
Halifax, Nova Scotia B3L 4G7
(902) 453-4300

## Quebec

*Retail Marketing and Service*

999 de Maisonneuve Blvd. W
Suite 1200
Montreal, Quebec H3A 3L4
(514) 288-4300

*Group Operations*

999 de Maisonneuve Blvd. W
Suites 1400/1500
Montreal, Quebec H3A 3L4
(514) 288-4300

## Ontario

PO Box 120, TD Centre
Maritime Life Tower
79 Wellington St. W
Toronto, Ontario M5K 1N9
(416) 864-8000

*Retail Marketing and Service – Central Northeast*

2300 Yonge St.
Suite 2800
Toronto, Ontario M4P 1E4
(416) 440-3672

*Retail Marketing and Service – South Western Ontario*

101 Frederick St.
The Galleria, Suite 650
Kitchener, Ontario N2H 6R3
(519) 579-4775

*Toronto Health and Dental Claims*

3080 Yonge St.
Suite 3040
Toronto, Ontario M4N 3P1
(416) 480-6250

## Western Canada

*Calgary*

*Retail Marketing and Service – Prairies*

Alberta Stock Exchange Tower
2040, 300-5th Ave., SW
Calgary, Alberta T2P 3C4
(403) 261-3994

*Group Operations*

324-8th Ave., SW
Suite 1300
Calgary, Alberta T2P 3N4
(403) 750-7300

*Vancouver*

*Retail Marketing and Service*
*Group Operations*

Four Bentall Centre
PO Box 49284
1055 Dunsmuir St.
Vancouver, British Columbia
V7X 1L3
(604) 689-1429

*Design*

Allura Communications Ltd.

*Illustration*

Kim Squared Inc.

*Principal Photography*

James Ingram
Bill Black *(p. 3)*
Phil Pothier *(p. 7)*
Erin McDonah *(p. 13)*

Warren Liebmann
Stephen Liptrap *(p. 9)*

Mike Ridewood
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Graphic Concepts Inc.

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Print Atlantic Limited

Printed with vegetable based inks on Horizon Silk paper, which is acid and chlorine-free.

**Annual General Meeting**
March 14, 2001, 11:00 a.m. (AST)
2701 Dutch Village Road, Halifax, Nova Scotia

**Stock Symbols**
Series A, First Preferred Shares: MMF.PR.A
Series 1, Second Preferred Shares: MMF.PR.B

**Version française**
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La Secrétaire de La Maritime, compagnie d'assurance-vie,
C.P. 1030, Halifax (Nouvelle-Écosse) B3J 2X5

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